97 ①

Supreme Court, U.S.
FILED

08-48 JUL 08 2008

No. ______

OFFICE OF THE CLERK
William K. Suter, Clerk

In the

Supreme Court of the United States

VERNON SCHAAF, JULIAN BOIK, and
ALFRED STREUFERT, on behalf of themselves and
others similarly situated,

Petitioners,

v.

RESIDENTIAL FUNDING CORPORATION,
HELLER FINANCIAL, INC.,

Respondents,

MARSHALL & ISLEY BANK,

Nominal Defendant.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

John A. Cochrane *Counsel of Record* COCHRANE & BRESNAHAN, P.A. 287 East Sixth Street Suite 262 St. Paul, MN 55101 Tel: (651) 298-1950 Fax: (651) 298-0089	Vernon J. Vander Weide Thomas V. Seifert HEAD, SEIFERT & VANDER WEIDE, P.A. 333 South Seventh Street Suite 1140 Minneapolis, MN 55402 Tel: (612) 339-1601 Fax: (612) 339-3372

Attorneys for Petitioners

2008 – Bachman Legal Printing ■ (612) 339-9518 ■ 1-800-715-3582 ■ Fax (612) 337-8053

QUESTIONS PRESENTED FOR REVIEW

I. Whether the Court below, in applying this Court's holding in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), a case construing causation under a federal securities statute, to Petitioners' Minnesota statutory and common law fraud causes of action, improperly failed to apply Minnesota's law of proximate causation where state law provides, contrary to the Court's ruling, (1) multiple causes may constitute loss causation, (2) proximate cause, including intervening cause, is a question for the trier of fact, and (3) Minnesota's consumer fraud statute requires a less exacting proof of causation than does common law fraud.

II. Whether the Court below improperly applied a loss causation standard to Petitioners' fraud claims that is contrary to other Circuits, which provide (1) multiple causes may constitute loss causation and (2) proximate cause, including intervening cause, is a question for the trier of fact, not to be resolved on a motion to dismiss.

III. Whether the Court below improperly failed to follow applicable state law in ruling that (1) Petitioners insufficiently alleged substantial assistance of a fraud, (2) Petitioners did not allege a claim for unjust enrichment, and (3) Petitioners are not entitled to rescission.

IV. Whether the Court below erred in its application of the standards for reviewing a motion to dismiss.

V. Whether, because it failed to respect Minnesota law, the Court below applied the Class Action Fairness Act, 28 U.S.C. §§ 1332(d), 1453(d), the sole basis of its jurisdiction, in an unconstitutional manner, thereby rendering it unconstitutional in its particular application in this case, and further thereby depriving the federal court of jurisdiction and requiring this case be remanded to Minnesota state court.

PARTIES TO THE PROCEEDINGS

Petitioners Schaaf and Streufert are natural persons; Petitioner Boik has died.

The putative class was defined as: "a class that includes all persons who purchased the Debentures in a public offering pursuant to a registration statement with the SEC and various states that began on November 25, 1997 and, based on [the underwriter's] practice of allowing purchasers to rescind their purchases and reselling the Debentures whose purchases were rescinded, continued thereafter until November 1999.. . . and a subclass that includes all persons who were "senior citizens" within the meaning of Minn.Stat § 325F.71 . . ."

The following companies were defendants/appellees and are the Respondents in this Court:

Residential Funding Corporation

Heller Financial, Inc.

The following company was joined as a nominal defendant because it was the trustee on the Indenture pertaining to the debentures purchased by the Petitioners:

Marshall & Isley Bank

TABLE OF CONTENTS

QUESTIONS PRESENTED ii

PARTIES TO THE PROCEEDINGS iii

TABLE OF AUTHORITIES vi

OPINIONS BELOW 1

JURISDICTION 1

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS 1

STATEMENT OF THE CASE 2

REASONS FOR GRANTING THE PETITION 2

I. The Eighth Circuit Was Constitutionally Required to Apply Minnesota Law and Its Failure to Do So Rendered CAFA Unconstitutional 4

  A. The Eighth Circuit Was Constitutionally Required to Apply Minnesota Law but Failed to Do So 4

  B. Because the Court's Failure to Apply Minnesota Law Rendered CAFA Unconstitutional in Its Application, CAFA Cannot Be the Basis for the Court's Jurisdiction, Requiring Remand 6

II. The Eighth Circuit Erred in Its Restrictive Application of Loss Causation and in Ignoring Minnesota Law That Is Much Less Restrictive, both as to Common Law and Statutory Fraud 8

A. The Eighth Circuit Improperly Ignored Specific Factual Allegations regarding Proximate/Intervening Cause............9

  1. The Eighth Circuit Correctly Recited but Misapplied the Standards Applicable to Reviewing a Motion to Dismiss 9

  2. United's nonpayment of interest was only one of "numerous" defaults that led RFC to stop lending to United.................. 10

  3. The Eighth Circuit ignored allegations that United's inability to service its debt was concealed 12

  4. The Eighth Circuit ignored allegations that United concealed RFC controlled United's ability to service its debt...................... 13

  5. Petitioners alleged a causal nexus between the 1997 omissons and misrepresentations and investors' losses; causation is a jury question.................................... 16

B. The Eighth Circuit's Restrictive Interpretation of Loss Causation Is Inconsistent with the Eighth and other Circuits...21

C. The Eighth Circuit Improperly Applied *Dura*'s Loss Causation Standard to the MCFA and Failed to Differentiate between Minnesota Statutory and Common Law Fraud........................24

D. Loss Causation Is Not an Element of Rescission.................................... 28

III. The Eighth Circuit Erred in Holding that Heller Was Not Unjustly Enriched Because It Was Entitled to the Payments It Received from the Fraudulent Sale of Its Borrower's Debentures to Petitioners... 29

IV. The Eighth Circuit Erred in Holding Petitioners Have Not Alleged How Defendants Substantially Assisted United's Fraud.. 31

CONCLUSION... 35

APPENDIX TABLE OF CONTENTS

Order Denying Petition for Rehearing (4/9/08)... A-1
Circuit Court of Appeals Decision (11/22/07)....... A-2
U.S. District Court Opinion (8/29/06)................A-19

TABLE OF AUTHORITIES

Cases

Ada v. Guam Soc'y of Obstetricians and Gynecologists, 506 U.S. 1011, 113 S.Ct. 633 (1992) 7
Allapattah Services, Inc. v. Exxon Corp., 454 F.Supp.2d 1185 (S.D. Fla.,2006) 4
Arthur Young & Co., v. Reves, 937 F.2d 1310 (8th Cir.1991)...22, 29
Baker v. Ploetz, 597 N.W.2d 347 (Minn.App.1999)..28
Bastian v. Petren Res. Corp., 892 F.2d 680 (7th Cir. 1990) 23
Bell Atlantic Corp. v. Twombly, __ U.S. __, 127 S.Ct. 1955 (2007). 10

Buetow v. A.L.S. Enterprises, Inc., 2008 WL 1994989 (D.Minn.,2008) 23
Caremark, Inc. v. Coram Healthcare Corp., 113 F.3d 645 (7th Cir.1997) 22, 23
City Council of Los Angeles v. Taxpayers for Vincent, 466 U.S. 789, 104 S.Ct. 2118 (1983) 8
Davis v. Re-Trac Mfg. Co., 149 N.W.2d 37 (Minn. 1967) 20
Dupont v. Haggard, 49 N.W.2d 186 (Minn.1951) 28
Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336 (2005) .... *passim*
Earle R. Hanson & Associates v. Farmers Cooperative Creamery Co., 403 F.2d 65 (8th Cir.1968) 30
Emergent Capital Investment Management, LLC v. Stonepath Group, Inc., 343 F.3d 189 (2d Cir.2003) 10
Erie R. Co. v. Tompkins, 304 U.S. 64 (1938) 5
Federal Deposit Insurance Corporation v. First Interstate Bank, 885 F.2d 428 (8th Cir.1989) 34
First Nat'l Bank of St. Paul v. Ramier, 311 N.W.2d 502 (Minn. 1981) 30
Franklin High Yield Tax-Free Income Fund v. County of Martin, Minn., 152 F.3d 736 (8th Cir. 1998) 23
Frazier v. Heebe, 482 U.S. 641, 107 S.Ct. 2607 (1986) 7
Group Health Plan, Inc. v. Philip Morris, Inc., 621 N.W.2d 2 (Minn.2001) 24, 25, 27, 28
Hanson v. Ford Motor Co., 278 F.2d 586 (8th Cir. 1960) 22
In re Daou Systems, Inc., 411 F.3d 1006 (9th Cir.,2005) 22
In re Enron Corp. Securities, Derivative & ERISA Litigation, 439 F.Supp.2d 692 (S.D.Tex.2006) 26-27
In re Salomon Analyst AT&T Litigation, 350 F.Supp.2d 455 (S.D.N.Y.2004) 26

Johnson v. Freberg, 228 N.W. 159 (1929)....................30
Larson v. Montpetit, 147 N.W.2d 580 (Minn.1966). 19
Lentell v. Merrill Lynch & Co., Inc., 396 F.3d 161 (2d Cir.2005)....................21, 22
LeSage v. Norwest Bank Calhoun-Isles, 409 N.W.2d 536 (Minn.App.1987)....................27
Lubbers v. Anderson, 539 N.W.2d 398 (Minn.1995)19, 20
Martel v. Stafford, 992 F.2d 1244 (1st Cir.1993).......5
Merrill Lynch, Pierce, Fenner & Smith, Inc. v. First Nat. Bank of Little Rock, Ark., 774 F.2d 909 (8th Cir.1985)....................30
Metge v. Baehler, 762 F.2d 621 (8th Cir.1985)...33, 34
Monsen v. Consolidated Dressed Beef Company, 579 F.2d 793 (3d Cir.1978)....................32, 34
Morlock v. St. Paul Guardian Ins. Co., 650 N.W.2d 154 (Minn.2002)....................20
Morse v. Frederick, 127 S.Ct. 2618 (2007)....................6
Muehler v. Land O'Lakes, Inc., 617 F.Supp. 1370 (D. Minn.,1985)....................5
Park-Lake Car Wash, Inc. v. Springer, 394 N.W.2d 505 (Minn.App.1986)....................30
PDK Labs., Inc. v. Drug Enforcement Admin., 362 F.3d 786 (C.A.D.C.2004)....................6
Ponticas v. K.M.S. Investments, 331 N.W.2d 907 (Minn.1983)....................19
Rieger v. Zackowki, 321 N.W.2d 16 (Minn.1982)....19, 20
Robbins v. Koger Props., Inc., 116 F.3d 1441 (11th Cir.1997)....................22
Sanjour v. E.P.A., 56 F.3d 85 (C.A.D.C.,1995)..........8
Schumacher v. Schumacher, 627 N.W.2d 725 (Minn.App.2001)....................31
ServiceMaster of St. Cloud v. GAB Bus. Servs., Inc., 544 N.W.2d 302 (Minn.1996)....................31

Specialized Tours, Inc. v. Hagen, 392 N.W.2d 520 (Minn.1986) 19, 20
Spies v. Brandt, 41 N.W.2d 561 (Minn.1950)....................28
State by Humphrey v. Alpine Air Prods., Inc., 500 N.W.2d 788 (Minn.1993)....................24
Sutton v. Viking Oldsmobile Nissan, Inc., 2001 WL 856250 (Minn.App., July 31, 2001)....................27
Trenholme v. QRS Diagnostic, L.L.C., 2006 WL 2601664 (Minn.App., Sept. 12, 2006) 27
United Mine Workers v. Gibbs, 383 U.S. 715 (1966)..5
United States v. James Daniel Good Real Property, 510 U.S. 43, 114 S.Ct. 492 (1993) 8
United States v. Kimbell Foods, Inc., 440 U.S. 715, 99 S.Ct. 1448 (1979)....................5
United States v. Salerno, 481 U.S. 739, 107 S.Ct. 2095 (1987) 7
Wells Elec., Inc. v. Schaper, 2006 WL 2807179 (Minn.App., Oct. 3, 2006)....................31
Wiegand v. Walser Automotive Groups, Inc., 683 N.W.2d 807 (Minn.2004)....................19, 24
Wilson v. Comtech Telecomms. Corp., 648 F.2d 88 (2d Cir. 1981) 22
Witzman v. Lehrman, Lehrman & Flom, 601 N.W.2d 179 (Minn.1999) 35
Wright v. Wright, 311 N.W.2d 484 (Minn.1981) 29
Xechem, Inc. v. Bristol-Myers Squibb Co., 372 F.3d 899 (7th Cir.2004)....................10
Yarrington v. Solvay Pharmaceuticals, Inc., 2006 WL 2729463 (Minn.App., Sept. 26, 2006) 27

Statutes

15 U.S.C. § 1125(a)....................25
28 U.S.C. § 1254....................1
Class Action Fairness Act, 28 U.S.C.A. § 1332 *passim*
Minn.Stat. § 325F.69....................2, 7, 19, 25, 26
Minn.Stat. § 8.31, subd. 3a....................*passim*

Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(4) 25, 27, 36

Rules

Fed. R. Civ. P. 12(b)(6) 3, 9, 10, 35

Treatises

Restatement (Second) of Torts §876 33

Constitutional Provisions

United States Constitution, Amend. VII.......... 1, 5, 35
United States Constitution, Amend. X............. 1, 5, 35

OPINIONS BELOW

The Court of Appeals opinion is reported at *Schaaf v. Residential Funding Corporation*, 517 F.3d 544 (8th Cir. 2008). The opinion of the United States District Court for the District of Minnesota is reported at 2006 WL 2506974.

JURISDICTION

The Eighth Circuit filed its opinion and judgment on February 22, 2008 and its order denying Petitioners' petition for rehearing on April 9, 2008. This timely Petition for Writ of Certiorari is filed pursuant to Supreme Court Rule 13. This Court has jurisdiction pursuant to 28 U.S.C. §§ 1332 and 1254.

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

United States Constitution, Amend. VII:

> In Suits at common law, ... the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

United States Constitution, Amend. X:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Class Action Fairness Act ("CAFA"), 28 U.S.C.A. § 1332:

> (d)(1) In this subsection--...
>
> (2) The district courts shall have original jurisdiction of any civil action in which the mat-

ter in controversy exceeds the sum or value of $5,000,000, exclusive of interest and costs, and is a class action in which--

> (A) any member of a class of plaintiffs is a citizen of a State different from any defendant;

Minn.Stat. § 8.31, subd. 1, 3a.:

> **Subdivision 1. Investigate offenses against the provisions of certain designated sections; assist in enforcement.** The attorney general shall investigate violations of the law of this state respecting unfair, discriminatory, and other unlawful practices in business, commerce, or trade, and specifically, but not exclusively, the....Prevention of Consumer Fraud Act (sections 325F.68 to 325F.70)....
>
> **Subd. 3a. Private remedies.** ....any person injured by a violation of any of the laws referred to in subdivision 1 may bring a civil action and recover damages....

Minn.Stat. § 325F.69 (Prevention of Consumer Fraud Act) ("MCFA"):

> **Subdivision 1. Fraud, misrepresentation, deceptive practices.** The act, use, or employment by any person of any fraud, false pretense, false promise, misrepresentation, misleading statement or deceptive practice, with the intent that others rely thereon in connection with the sale of any merchandise, whether or not any person has in fact been misled, deceived, or damaged thereby, is enjoinable as provided in section 325F.70.

STATEMENT OF THE CASE

Petitioners allege that two lenders, by their false representations to regulators and the underwriter, enabled their debtor to raise $7 million in debentures from Petitioners and other public investors that the debtor desperately needed to cure financial covenant violations under the lenders' threats to terminate their loans. Petitioners allege that the issuer was in default at the time of the offering and thereafter until the issuer collapsed after one of the lenders refused to continue making loans because of the defaults.

This case originated in Hennepin County, Minnesota, District Court and was removed pursuant to CAFA. In affirming the dismissal of Petitioners' complaint pursuant to Federal Rule of Civil Procedure 12(b)(6), the Eighth Circuit rewrote Minnesota's law of fraud, unjust enrichment, rescission, and aiding and abetting. The decision runs counter to constitutional mandates that federal courts decide state law issues in accordance with state law.

The Eighth Circuit's restrictive interpretation of loss causation for purposes of Minnesota's MCFA ignores the Minnesota Supreme Court's repeated rulings that the MCFA is remedial and is broader than common law fraud. The Eighth Circuit applied this Court's decision interpreting federal securities law, ignoring the Minnesota Supreme Court's distinction between common law fraud and MCFA loss causation. The Eighth Circuit ignored long-established Minnesota law and that of other Circuits regarding intervening causation—i.e., that an intervening cause must be unforeseeable and that it must be the sole cause of Petitioners' loss and not only a partially contributory factor requiring apportionment—and that causation is for the trier of fact to decide.

This Petition asks this Court to reverse a ruling that replaces state law regarding proximate cause with a federalized notion of loss causation derived from a federal statute and that replaces states' juries with federal courts determining intervening cause without allocation between foreseeable and unforeseeable causes. This Petition further seeks review of the Eighth Circuit's ruling regarding rescission, unjust enrichment and aiding and abetting, for failure to follow other Circuits' and Minnesota law.

REASONS FOR GRANTING THE PETITION

I. The Eighth Circuit Was Constitutionally Required to Apply Minnesota Law and Its Failure to Do So Rendered CAFA Unconstitutional.

A. The Eighth Circuit Was Constitutionally Required to Apply Minnesota Law but Failed to Do So.

Under CAFA, litigation raising state law issues will increasingly be swept into federal courts, depriving state courts of the opportunity to interpret state statutes that protect citizens from deceit. This poses serious implications for our federal-state system. Because class actions are the only vehicle by which persons of modest means can vindicate rights and protect interests given to them by state law but individually having modest values, federal courts will replace state courts in interpreting state law.[1]

---

[1] It has been said that the class action is "the poor man's keys to the courthouse." *Allapattah Services, Inc. v. Exxon Corp.*, 454 F.Supp.2d 1185, 1217 (S.D. Fla.,2006), *citing*

It is axiomatic that federal courts apply state substantive law in diversity suits. *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938). "There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a state whether they be local in their nature or 'general,' be they commercial law or a part of the law of torts." *Id.* To preserve federal-state comity, federal courts must exercise restraint when addressing novel issues under state law. *United Mine Workers v. Gibbs,* 383 U.S. 715, 726 (1966)("Needless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a surer-footed reading of applicable law."). A federal court is not to be expected "to steer state law into unprecedented configurations." *Martel v. Stafford,* 992 F.2d 1244, 1247 (1st Cir.1993). Unless application of a state law would frustrate a federal program, federal courts should "incorporat[e] [state law] as the federal rule of decision." *United States v. Kimbell Foods, Inc.,* 440 U.S. 715, 728 (1979).

The Eighth Circuit's causation ruling is not only novel under, but is contrary to, Minnesota law regarding proximate/intervening cause, and that Court identified no federal program that is frustrated by the application of Minnesota law to Petitioners' Minnesota claims. By depriving Petitioners of a jury trial on their state law claims to resolve what clearly are fact issues, the Eighth Circuit's decision denies them rights guarantied by the Seventh and Tenth Amendments to the United States Constitution. In

---

Muehler v. Land O'Lakes, Inc., 617 F.Supp. 1370, 1375 (D. Minn.,1985).

reaching as far as it has to replace Minnesota statutory fraud proximate causation with a federal loss causation doctrine, contrary to *Erie*'s explicit teaching, the Court has engaged in egregious judicial activism, violating the "cardinal principle of judicial restraint" that "if it is not necessary to decide more, it is necessary not to decide more." *Morse v. Frederick,* 127 S.Ct. 2618, 2641-42 (2007)(Breyer, J., concurring in part and dissenting in part)(*citing PDK Labs., Inc. v. Drug Enforcement Admin.,* 362 F.3d 786, 799 (C.A.D.C.2004)(Roberts, J., concurring in part and concurring in judgment)). It was not necessary to—indeed, the Court was precluded from—rewriting Minnesota's statutory and common law fraud law in deciding this appeal.

B. Because the Court's Failure to Apply Minnesota Law Rendered CAFA Unconstitutional in Its Application, CAFA Cannot Be the Basis for the Court's Jurisdiction, Requiring Remand.

A statute need not be facially unconstitutional to be unconstitutional in a particular case. A facially constitutional statute may be rendered unconstitutional by its application in a particular case. The Eighth Circuit's decision is an unconstitutional exercise of federal jurisdiction. Petitioners do not contend that CAFA is facially unconstitutional, only that it is unconstitutional as applied in this case.

The Eighth Circuit's jurisdiction is based solely on CAFA. Because the Eighth Circuit declined to apply Minnesota law, thereby failing to adhere to the constitutional limits on the exercise of its jurisdiction under CAFA, it misapplied CAFA, rendering CAFA unconstitutional in its application to this particular case. CAFA having become unconstitutional, in this case, it can no longer be a basis for federal jurisdiction. Because the panel ignored *Erie's* limitations on federal courts construing state law, thereby violating the Tenth Amendment, CAFA, in its conferral of jurisdiction in this case, is unconstitutional. Likewise, the Eighth Circuit's usurping of the jury's role in deciding intervening cause violated the Seventh Amendment's guaranty of a jury trial. That is not to say CAFA is facially unconstitutional; it is unconstitutional only where the federal court's exerise of CAFA jurisdiction fails to abide by the constitutionally grounded doctrines of *Erie* and *Gibbs*. Accordingly, this action should be remanded to Minnesota state court.

A court may hold a statute unconstitutional either because it is invalid "on its face" or because it is unconstitutional "as applied" to a particular set of circumstances. *Ada v. Guam Soc'y of Obstetricians and Gynecologists,* 506 U.S. 1011, 1012 (1992) (Scalia, J., dissenting), *denying cert. to* 962 F.2d 1366 (9th Cir.1992). "Statutes are ordinarily challenged, and their constitutionality evaluated, 'as applied'—that is, the plaintiff contends that application of the statute in the particular context in which he has acted, or in which he proposes to act, would be unconstitutional. The practical effect of holding a statute unconstitutional 'as applied' is to prevent its future application in a similar context, but not to render it utterly inoperative." *Id.* at 1012 (citing *United States v. Salerno,* 481 U.S. 739, 745 (1987)); *see also, e.g., Frazier v. Heebe,* 482 U.S. 641, 643 (1986) (petition alleged unconstitutionality of a regulation on its face and as applied); *United States v. James Daniel Good Real Property,* 510 U.S. 43, 77 (1993) (O'Connor, J., concurring in part, dissenting in part)(characterizing the constitutional challenge in that case as "as applied"). The courts recognize "the usual distinction between 'as-applied' and 'facial' challenges is that the former ask only that the reviewing court declare the challenged statute or regulation unconstitutional on the facts of the particular case; the latter, in contrast, request that the court go beyond the facts before it to consider whether, given all of the challenged provision's potential applications, the legislation creates such a risk of curtailing protected conduct as to be constitutionally unacceptable 'on its face.'" *Sanjour v. E.P.A.*, 56 F.3d 85, 92 (C.A.D.C.,1995) (*citing City Council of Los Angeles v. Taxpayers for Vincent,* 466 U.S. 789, 796-98 & nn. 12-16 (1983)).

II. The Eighth Circuit Erred in Its Restrictive Application of Loss Causation and in Ignoring Minnesota Law That Is Much Less Restrictive, both as to Common Law and Statutory Fraud.

The Eighth Circuit's decision ignored established Minnesota law on loss causation regarding both common law and MCFA fraud. The Eighth Circuit exceeded its proper function by ignoring relevant factual allegations and assuming facts and deciding fact issues.

Petitioners alleged that, because of its heavy debt and defaults of various covenants of Defendants' loan agreements beginning September 30, 1996, United Homes, Inc. ("United") was pressured by its lenders, Defendants Residential Funding Corporation ("RFC") and Heller Financial, Inc. ("Heller"), to obtain additional capital in late 1997.[2] The Eighth Circuit ignored Petitioners' extensive and detailed allegations and/or improperly resolved factual issues on a motion to dismiss.

A. The Eighth Circuit Improperly Ignored Specific Factual Allegations regarding Proximate/Intervening Cause.

The Eighth Circuit concluded it was not United's persistent violations of its debt/worth covenant but "United's failure to pay interest on its loans [that] caused RFC to foreclose on the loans" and, therefore, Petitioners' losses. Eighth Circuit Opinion ("Op.") 11. The Court erred because: (1) Petitioners did allege that United's inability to pay interest on its debt, and RFC's control thereof, were concealed and (2) United's nonpayment of interest was only one of "numerous" defaults that led RFC to stop lending to United. While the Eighth Circuit recited the standards applicable to reviewing Rule 12(b)(6) dismissals, it resolved factual issues and ignored specific factual allegations.

1. The Eighth Circuit Correctly Recited but Misapplied the Standards Applicable to Reviewing a Motion to Dismiss.

The Eighth Circuit properly recited that all of the factual allegations contained in the complaint are to be accepted as true, the complaint is reviewed to determine whether its allegations show that the pleader is entitled to relief, and that a "plaintiff must include sufficient factual information to provide the 'grounds' on which the claim rests, and to raise a right to relief above a speculative level,", *citing Bell Atlantic Corp. v. Twombly,* 127 S.Ct. 1955, 1964-65 (2007). A-6-7. The Court also said the "complaint must 'provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind,'" *citing Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336, 347 (2005). A-7. "Otherwise," said the Eighth Circuit, "a plaintiff with no hope of showing proximate causation could require inefficient expenditure of resources and potentially induce a defendant to settle a meritless claim" *citing Dura.* A-7.

---

[2] *Appellants/Plaintiffs' Appendix to Appellants' Brief to Eighth Circuit ("PA:__"):104-07[¶¶472-97].* Because the complaint is 133 pages long, it is not included in the Appendix herein; if this Petition is granted, it will be included in support of the brief.

In concluding Petitioners have not alleged proximate causation, the Court ignored the abundant law that affirmative defenses (e.g., intervening cause) may not be the basis for dismissal under Fed. R. Civ. P. 12(b)(6). *Xechem, Inc. v. Bristol-Myers Squibb Co.,* 372 F.3d 899, 901 (7th Cir.2004) ("Orders under Rule 12(b)(6) are not appropriate responses to the invocation of defenses, for Petitioners need not anticipate and attempt to plead around all potential defenses."); *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.,* 343 F.3d 189, 197 (2d Cir.2003) (loss caused by an intervening event "is a matter of proof at trial and not to be decided on a Rule 12(b)(6) motion to dismiss").

2. United's nonpayment of interest was only one of "numerous" defaults that led RFC to stop lending

to United.

The Eighth Circuit says, "United's failure to pay interest on RFC's loans [was cited by RFC] as its *primary example* of *numerous default events* before foreclosing on the loan's collateral." A-12 (emphasis supplied). The Court then concluded: "Thus, the investors' losses were not 'caused by the materialization of the concealed risk' that Heller and RFC would declare a default because of United's breach of its debt-to-worth covenants in 1997." *Id.*

The Eighth Circuit says this despite the fact that the very allegation upon which the Eighth Circuit relies for its holding regarding the cause of United's failure and investors' losses quotes from a RFC document that says nonpayment of interest was only *one* of "numerous" defaults. *PA:91[¶404]*.[3] The others included United's persistent violations of its debt/worth covenant, its need for—and failure to obtain—additional capital, and its continuous cash flow problems, all of which are alleged to have been concealed. *PA:13-20[e.g., ¶¶41-42]*[4], *36-37[¶¶124-25],*

---

[3] 404. By letter dated February 8, 2000, RFC wrote to UHI as follows: "As you have acknowledged numerous times over the last year, and as been confirmed in numerous letters from RFC to United, all of the loan facilities from RFC to United Homes....are in default and have been declared and are presently due and payable. *The Events of Default are numerous and include, but are certainly not limited to*, the fact that interest on the loans has not been paid since December, 1998." (emphasis supplied).

[4] 41(b) .... UHI was, even before entering into an underwriting agreement with MSF, seeking up to $40 million in additional capital but was never successful in obtaining it.

42. RFC knew that UHI was seeking up to $40 million in additional capital but was never successful in obtaining it.

87-91[¶¶380-408],[5] *99-113[e.g., ¶¶471-98]*[6]. Notwithstanding Petitioners' allegations identifying these "numerous default events," the Court erroneously treats this "primary example" as the *sole* cause of RFC's refusal to continue lending and Petitioners' losses.

3. The Eighth Circuit ignored allegations that United's inability to service its debt was concealed.

In holding that RFC shut down United, thereby causing investors' losses, because United did not pay interest on its RFC debt, the Eighth Circuit ignored allegations that United concealed its inability to service—i.e., pay interest on—its debt. The Court ignored the allegations that United and Heller concealed from investors United's default of Heller's covenant that measured United's ability to pay interest on its debt and that United and underwriter Miller & Schroeder Financial, Inc. ("Miller") concealed United's cash flow problems. *PA:24-26[¶¶64-*

---

[5] 382. By letter dated November 16, 1998, RFC informed UHI that UHI was in violation of the RFC debt/worth ratio.

394. ....on or before April 5, 1999, UHI must deliver to RFC evidence...that at least one or more of the following events have occurred, including, ...additional equity capital has been infused into United, and/or UHI has commenced liquidation of other assets. RFC further advised UHI that, in the absence of significant progress on these events, RFC "will make no further disbursements of any of the loans and will exercise our other remedies under the loan documents, including commencing foreclosure proceedings."

[6] 491. RFC knew since February 1997 of UHI's efforts to raise capital in an amount greater than the net proceeds from the Debentures.

69], 36-37[¶¶124-25].[7] The Eighth Circuit likewise ignored allegations that United's prospectus contained a contrived measure of its ability to service its debt and failed to disclose United's chronically deficient capital and dependency on Defendants' loans to service the debentures. *PA:13-20[¶¶31-49],*[8] *102-07[¶¶471-97], 118-20[¶¶534-40].*

4. The Eighth Circuit ignored allegations that United concealed RFC controlled United's ability to service its debt.

The Court said "plaintiffs have not adequately alleged how RFC's 1998 letter [from RFC to United that United was in breach of the debt/worth covenant], or the breach it recognized, *caused* RFC to stop lending money to United" that United needed to pay interest on the debentures in June 1999 and further said Petitioners allege "that RFC's critical refusal to lend occurred later, in June 1999." A-12. The Court then concludes: "Thus, United's default on the debt-to-worth covenant, *in and of itself*, cannot have caused RFC to discontinue the necessary lending to United." *Id.*(emphasis supplied).

---

[7] 125. ....UHI was in default of [Heller's] minimum fixed charge coverage ratio from September 30, 1996 through December 31, 1997.

[8] 37. [Prospectus] failed to disclose....That, although UHI could not service the debentures without being able to continue to borrow from Heller and RFC, the Heller and RFC loan agreements restricted UHI's ability to use loan proceeds to service UHI's debentures.

45. The "Ratio of Earnings to Adjusted Fixed Charges" disclosed in the prospectus was "misleading" and "contrived."

First, as a matter of law, United's default of its debt/worth covenant need not be the sole cause of RFC's decision to stop lending. *See infra.*

Second, Petitioners actually have alleged "how RFC's 1998 letter, or the breach it recognized, *caused* RFC to stop lending money to United." United's excessive debt—recognized by RFC when it said United was in violation of the debt/worth covenant—was too much for United to handle, especially given United's inadequate cash flow, so it was no surprise that United could not, starting in December 1998, pay the interest it owed RFC on its excessive RFC debt. *PA:68-69[¶¶276-79],*[9] *87-91[¶¶380-405].* United's failure to pay interest led to RFC's refusal to allow United to pay the interest due on the debentures in June 1999. That a debtor with too much debt and negative cash flow is eventually unable to pay the interest on that debt is totally foreseeable. At least Petitioners should be given the opportunity of proving that to a jury.

Third, Petitioners alleged a causal nexus between the fraudulent disclosures in November 1997 and RFC's refusal to allow United to pay interest on the debentures in June 1999. Petitioners expressly alleged that the November 1997 debenture prospectus did not disclose RFC's ability to control United's payments on its debentures. This RFC ability, along with the misrepresentation regarding United's covenant violations, were undisclosed risks/facts that materialized in June 1999. *PA:14-15[¶¶34-37(c)-(e)], 90[¶¶397-403].*[10]

---

[9] 276. By letter dated November 16, 1998, RFC informed UHI that UHI was in violation of RFC's debt/worth ratio.

278. By letter agreement dated December 22, 1998, in order to avoid disclosing in UHI's 1998 audited financial statements that UHI was in default of the RFC Loan Agreement, RFC agreed to certain amendments to the Loan Agreement, and RFC represented to UHI's auditors, for purposes of issuing "their 10-K opinion to our bondholders, that there were no items of noncompliance, as a result of the loan document amendments."

279. By letter dated February 2, 1999, RFC informed UHI that the loans "are presently in default and accordingly RFC is entitled to withhold further disbursement and to exercise its rights and remedies under the Loan Documents."

Fourth, in allowing United to sell its debentures in Minnesota, Minnesota's regulators relied on United's continuing ability to borrow from Defendants, which they assumed United could do in the absence of any disclosed defaults. *PA:99-101[¶¶452-62].*

Fifth, United blamed RFC's refusal to honor its lending commitments for United's cash flow problems. *PA:108-09[¶498].*

Thus, what the Eighth Circuit describes as "RFC's critical refusal to lend [that] occurred later in June 1999," which caused a default of the debentures, was a risk Petitioners alleged was concealed in November 1997 when United failed to disclose its dependency on Defendants' loans to service the debentures, RFC's ability to control United's ability to service the debentures, United's cash flow problems, and United's existing defaults when the debentures were sold, all of which threatened RFC's willingness to continue lending to United to enable it to service the debentures. *Id., PA:14-15[¶¶34-37(c)-(e)], 19-20[¶¶43-49], 90[¶¶397-403].*

---

[10] 34. In connection with sales of the UHI debentures to plaintiffs and putative class members and with the purpose and intent of inducing plaintiffs and putative class members to purchase the debentures, MSF distributed a prospectus to debenture purchasers that disclosed: "The Company may re-borrow amounts repaid under either line for general corporate purposes, including....working capital."

35. The prospectus disclosure referenced in the preceding paragraph was false because the HFI and RFC loan agreements restricted UHI's ability to use loan proceeds to service UHI's debentures, and in 1999 RFC prohibited UHI from using borrowings under the RFC line of credit to pay interest and principal on the Debentures.

5. Petitioners alleged a causal nexus between the 1997 omissons and misrepresentations and investors' losses; causation is a jury question.

Significantly, the Eighth Circuit never used the terms "intervening" or "superseding" cause. For example, the Court suggested that investors' losses might have been caused, not by United's precarious financial condition and heavy debt that violated defendants' financial covenants and that United could not service, but by "poor home sales in the fall of 1998." A12-13. The poor home sales were not an intervening cause of Petitioners' loss; in fact, United blamed RFC's refusal to honor its loan commitments for United's loss of home sales. *PA:108-09[¶498].* RFC's refusal resulted from United's continuous loan covenant violations. Engaging in impermissible speculation, the Court notes only that such a "change in economic circumstances *could* defeat a plaintiff's attempt to prove loss causation," not that it actually *would*. A-13 (emphasis supplied).[11]

---

[11] The Eighth Circuit placed great significance on the lapse of time from the November-December 1997 debenture offering to United's bankruptcy in March 2000. A-12. United de-

Every business has its ups and downs, including the home building industry. *PA:108-09[¶498].* A well-capitalized company can survive these temporary downturns; an inadequately capitalized company in violation of its lenders' loan agreements with negative cash flow cannot. Thus, any such sales downturn, even if not attributable to RFC's refusal to fund loan commitments because of United's persistent covenant violations (which it was), cannot be adjudged the *sole unforeseen* cause of investors' losses, especially not on a motion to dismiss.

It is for a jury instructed on Minnesota law regarding proximate/intervening cause, not a federal appellate court wholly ignoring Minnesota law on intervening cause, to decide whether it was foreseeable that: (i) United's undisclosed need for substantial additional capital and defaults of Defendants' debt/worth covenants, together with its concealed cash flow problems and inability to service its excessive debt, caused RFC to stop funding its loan commitments for new construction in November 1998, (ii) exacerbating United's undisclosed already severe cash flow problems, (iii) leading to United's nonpay-

---

faulted on its debentures in June 1999, and RFC cited United's defaults going back to December 1998. The Eighth Circuit discounted Heller's default declaration in April 1998 because Heller cited only reporting violations. Reporting violations can be a convenient pretext for terminating an unwanted lending relationship. Plaintiffs should be permitted the opportunity to develop this evidence by deposing Heller officials as to whether the reporting violations were the real reason for the default declaration. In early 1997, Heller notified United only of its debt/worth covenant defaults at September 30, 1996, even though United was also almost three months late in providing its 1996 audited annual report. *PA:27[¶¶74-5], 30[¶90], 37[¶126], 105[¶¶481-83].*

ment of interest on RFC's loan in December 1998, (iv) causing United's default on the debentures in June 1999 when United did not pay interest because RFC prohibited United from doing so, (v) eventually leading RFC to foreclose on its collateral, (vi) thereby putting United out of business and rendering the debentures worthless, all of which is alleged.[12]

The Eighth Circuit purported to be unable to find a "causal nexus" between a failure to pay interest in 1998 and debt so excessive in 1997 that it violated Defendants' loan agreements' debt limits, subjecting United to pressure from Defendants to reduce its debt/worth ratio by raising additional capital.[13] Purportedly unable to see that an inability to pay interest on debt can foreseeably result from excessive debt, the Court ignored the possibility a jury might conclude from their collective experience that too much debt foreseeably leads to an inability to service it. Petitioners should be allowed the opportunity to prove that excessive debt foreseeably leads to inability to service that debt and that lenders include covenants like debt/worth to limit that risk; indeed, maybe even Defendants would, if deposed, admit the obvious purpose of such covenants. Based on these allegations, it is just plain wrong to suggest Petitioners have "*no hope* of showing proximate causation." A-7 (emphasis supplied).

---

[12] *PA:16-20[¶¶38-49], 28-37[¶¶80-127], 65-71[¶¶257-89], 77-9[¶¶321-48], 86-91[¶¶373-408], 104-11[¶¶472-500], 113-14[¶¶514-18].*

[13] The additional capital came in the form of additional debt (debentures), to which Defendants agreed because they were willing, but only temporarily, to view the additional debt as "equity," since it was subordinated to their loans, or to exclude the debentures from United's "debt." *PA:54[¶203], 57[¶¶219-21], 86[¶¶373-79], 107[¶¶492-93].*

The issue of what caused Petitioners' loss—i.e., whether an unforeseen intervening event solely, or only partially, caused Petitioners' loss—is a fact issue for a jury to decide, under Minnesota law. *Lubbers v. Anderson,* 539 N.W.2d 398, 401-02 (Minn.1995)(causation is question of fact for jury); *Wiegand v. Walser Automotive Groups, Inc.*, 683 N.W.2d 807, 812 (Minn.2004) (reversed Rule 12 dismissal of MCFA claim based on causation).

Notwithstanding the Eighth Circuit's ruling, the events in 1999 were foreseeable consequences of the undisclosed risks and of Defendants' misrepresentation to Miller regarding United's compliance with Defendants' loan covenants in November 1997. A defendant cannot avoid liability by an intervening cause that was reasonably foreseeable. *Larson v. Montpetit,* 147 N.W.2d 580, 583 n. 4 (Minn.1966). If the risk of harm attributable to other factors was foreseeable, the cause is not superseding. *Rieger v. Zackowki,* 321 N.W.2d 16, 21 (Minn.1982). An intervening cause is superseding only if its harmful effects occurred after the original event, it was not caused by that event, it actively worked to bring about a result that would not otherwise have followed from that event, and it was not reasonably foreseeable by the original wrongdoer. *Ponticas v. K.M.S. Investments,* 331 N.W.2d 907, 915 (Minn.1983). The causal nexus between a misrepresentation or omission and a plaintiff's loss is established if the loss is one that "might be expected to follow from the fraud and from events that are reasonably foreseeable." *Specialized Tours, Inc. v. Hagen,* 392 N.W.2d 520, 537 (Minn.1986). Only losses due to factors *in no way related* to the fraud are not recoverable. *Id.*

Defendants' false certificates need not be the sole, or even the specifically foreseeable, cause of Petitioners' injury. *Lubbers,* 539 N.W.2d at 401-02 (proximate cause means the injury was one the tortfeasor ought to have anticipated was likely to result in injury to others, though he could not have anticipated the particular injury which did happen). A plaintiff in Minnesota need only prove that the fraud was a "substantial factor" in causing plaintiff's loss. *Davis v. Re-Trac Mfg. Co.,* 149 N.W.2d 37, 39 (Minn. 1967); *Lubbers,* 539 N.W.2d at 401-02 (defendant's conduct need only be "a substantial factor in bringing about the injury"); *Rieger,* 321 N.W.2d at 24. Damages may be apportioned between tortious and nontortious causes. *Morlock v. St. Paul Guardian Ins. Co.,* 650 N.W.2d 154, 163 (Minn.2002)(*citing* Restatement (Third) of Torts §26).

A jury would doubtlessly understand that the reason lenders, including Defendants, are concerned about the amount of a borrower's debt is that interest must be paid—ability to pay interest is inextricably linked to the amount of a debtor's debt. Otherwise, the debt/worth ratio would be of no concern, and there would be no need for such covenants in loan agreements. In holding that United's failure to pay interest has nothing to do with its violation of loan covenants limiting debt, the Eighth Circuit defied common experience and usurped the jury's function.

With phrases such as "more *likely* that other factors caused the loss" and "change in economic circumstances *could* defeat a plaintiff's attempt to prove loss causation," the Eighth Circuit improperly speculated on a motion to dismiss about evidence that has not even been fully discovered. A 12-13. By saying, "United's default on the debt-to-worth covenant, *in and of itself*, cannot have caused RFC to discontinue the necessary lending to United" and "United's failure to pay interest on RFC's loans [was cited by RFC] as its *primary example* of *numerous default events* before foreclosing on the loan's collateral" (A-12)(emphasis supplied), the Court conceded that the debt/worth covenant default was at least *one*, even though perhaps not the *only*, cause of investors' losses. In holding that a concealed risk must "in and of itself" be the cause of investors' losses, and cannot be one of several causes, the Court applied an incorrect loss causation standard, ignoring the issues of whether what the Court saw as the "primary" cause was foreseeable and allocation of damages between foreseeable unforeseeable intervening events. In doing so, the Court failed to follow Minnesota law.

B. The Eighth Circuit's Restrictive Interpretation of Loss Causation Is Inconsistent with the Eighth and other Circuits.

The Court's statement that "United's default on the debt-to-worth covenant, *in and of itself*, cannot have caused RFC to discontinue the necessary lending to United" is also contrary to other Circuits' view of loss causation. A plaintiff sufficiently pleads loss causation by alleging "facts that support an inference that [the defendant's] misstatements and omissions concealed the circumstances that *bear* upon the loss suffered such that Petitioners would have been spared all or an ascertainable *portion* of that loss absent the fraud." *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 175 (2d Cir.2005)(emphasis supplied).[14] "[A] misstatement or omission is the 'proximate cause' of an investment loss if the risk that caused the loss was within the *zone of risk concealed* by the misrepresentations and omissions alleged by a disappointed investor." *Id.* at 173 (emphasis supplied); *Caremark, Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 649 (7th Cir.1997) (loss causation does not require that plaintiff plead that all of its loss is attributable to defendant's false statement); *see also Arthur Young & Co., v. Reves*, 937 F.2d 1310, 1332 (8th Cir.1991)(plaintiff need not prove that the defendant's conduct was the only cause of the plaintiff's injury); *Hanson v. Ford Motor Co.*, 278 F.2d 586, 595 (8th Cir.1960)(applying Minnesota law, damages are proximately caused even if not within the contemplation of the wrongdoer or his adversary at the time representations made).

A plaintiff is not required to show "that a misrepresentation was the *sole* reason for the investment's decline in value" in order to establish loss causation. *In re Daou Systems, Inc.*, 411 F.3d 1006, 1025 (9th Cir.,2005) (*citing Robbins v. Koger Props., Inc.,* 116 F.3d 1441, 1447 n. 5 (11th Cir.1997) (emphasis added). "[A]s long as the misrepresentation is one substantial cause of the investment's decline in value, other contributing forces will not bar recovery under the loss causation requirement" but will play a role "in determining recoverable damages." *Id.* "The plaintiff is not required to prove that the defendant's act was the sole and exclusive cause of his injury; he need only show that it was substantial, i.e., a significant contributing cause." *Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 88, 92 (2d Cir.1981)(internal quotation marks and citation omitted).

---

[14] *Dura* approvingly cited *Lentell*. 544 U.S. at 340, 344.

But for Defendants' misrepresentations that concealed United's defaults, Petitioners would not have purchased the debentures that resulted in their losses. *PA:51-54[¶¶196-203], 93[¶¶416-19], 96[¶438];*[15] *see Franklin*, 152 F.3d at 740 (alleging that investor would not have purchased the bonds but for defendants' misrepresentations and purchase resulted in loss alleges loss causation, *citing Caremark*); *Caremark*, 113 F.3d at 648-49 (plaintiff must allege that "but for the circumstances that the fraud concealed, the investment....would not have lost its value," *citing Bastian* at 685); *Bastian v. Petren Res. Corp.*, 892 F.2d 680, 685 (7th Cir. 1990) (alleging "but for the defendant's wrongdoing, the plaintiff would not have incurred the harm of which he complains" satisfies loss causation).[16] *See Buetow v. A.L.S. Enterprises, Inc.*, 2008 WL 1994989, 6 (D.Minn.,2008) (allegations that plaintiffs would not have purchased product "but for the [mis]representations made by" defendants "suffice to show the required causal connection between [defendant's] wrongful conduct and [plaintiffs'] losses." "Indeed, it is hard to conceive what more [defendant] would have Plaintiffs plead in order to provide 'some indication of the loss and the causal connection that [Plaintiffs] ha[ve] in mind.") (quoting from and distinguishing the Eighth Circuit's decision herein).

---

[15] 438. But for Heller's and RFC's representations to MSF that UHI was in compliance with the Heller and RFC loan agreements, which representations were used by UHI and MSF to gain the approval of the SEC and state regulators, including the Minnesota Department of Commerce, to allow the sale of the Debentures to public investors, the Debentures would never have been sold, and plaintiffs and the other putative class members would have avoided the losses they incurred as a result of having purchased the Debentures.

[16] *Dura* approvingly cited *Bastien*. 544 U.S. at 340, 344.

C. The Eighth Circuit Improperly Applied *Dura*'s Loss Causation Standard to the MCFA and Failed to Differentiate between Minnesota Statutory and Common Law Fraud.[17]

Contradicting Minnesota law and relying on *Dura,* the Court failed to address the less onerous proofs required for a MCFA claim versus a common law fraud claim, instead imposing a single, burdensome loss causation standard for Minnesota statutory and common law fraud, without differentiating between the two. A-10-11.

Minnesota's MCFA is to be broadly construed in favor of those protected because of its remedial purpose. *Group Health Plan, Inc. v. Philip Morris, Inc.,* 621 N.W.2d 2, 9-10 (Minn.2001). The MCFA is broader than common law fraud and reduces the burden on plaintiffs by eliminating proof requirements for common law fraud. *Id.* at 9; *Wiegand,* 683 N.W.2d at 813; *State by Humphrey v. Alpine Air Prods., Inc.,* 500 N.W.2d 788, 790 (Minn.1993) ("In passing consumer fraud statutes, the legislature clearly intended to make it easier to sue for consumer fraud than it had been to sue for fraud at common law. The legislature's intent is evidenced by the *elimination* of elements of common law fraud, such as proof of damages or reliance on misrepresentations."). In *Group Health,* the Minnesota Supreme Court suggested the Lanham Act, 15 U.S.C. § 1125(a), offered guidance regarding the appropriate causation nexus; under that statute, a defendant's deliberately deceptive conduct establishes a sufficient causal nexus. 621 N.W.2d at 15 n.11.

---

[17] Minnesota's Attorney General filed an *amicus* brief in support of the arguments herein regarding the loss causation standard applicable under the MCFA.

This case is significantly different than *Dura.* In *Dura,* this Court addressed loss causation in a fraud-on-the-market Rule 10b-5 case; this is not such a case because there was no efficient market for United's debentures. Thus, *Dura's* concern about what might cause a market price to drop over time is not relevant here. *See* 544 U.S. 342-43. While *Dura* applies the common law fraud concept of proximate cause, 544 U.S. at 343, the Minnesota Supreme Court explicitly rejected "a strict showing of direct causation, as would be required at common law" to prove damages under the MCFA. *Group Health*, 621 N.W.2d at 14. Moreover, *Dura* interpreted common law fraud causation in the limiting context of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. § 78u-4(b)(4). 544 U.S. at 345-46 (PSLRA "expressly imposes on plaintiffs 'the burden of proving' that the defendant's misrepresentations 'caused the loss for which the plaintiff seeks to recover.'"). In contrast to PSLRA, whose widely-acknowledged purpose is to limit investors' ability to recover for fraud, the MCFA imposes no such burden on victims of fraud but more broadly provides a remedy for deceitful conduct without the necessity of strict proof of the elements of common law fraud, basing causation on the extent to which a defendant's conduct was deliberately deceitful.

Dura narrowly involved a claim of inflated stock value at the time of purchase as the sole basis of loss causation. 544 U.S. at 346 (to plead loss causation, plaintiff asserting fraud-on-the-market claim must allege more than that stock was inflated at time of purchase); *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 439 F.Supp.2d 692, 713-14 (S.D.Tex.2006) (*Dura*'s "holding was narrow, i.e, that to allege loss causation a plaintiff pleading a fraud-on-the-market claim under §10(b) must plead more than that it purchased stock at an inflated price because of a defendant's misrepresentation (or wrongful conduct) and thus suffered a loss"). In this case, loss causation is based on concealed defaults and risks that continued and subsequently materialized, causing United's demise. *See In re Salomon Analyst AT&T Litigation*, 350 F.Supp.2d 455, 471 (S.D.N.Y.2004) (in applying *Dura*-approved Second Circuit loss-causation law, court noted that plaintiffs were not relying on artificial price inflation as the sole explanation for their claimed losses but set out a causal chain linking their losses to the alleged fraud).

This case and *Dura* differ in another important respect. *Dura* recognized that a plaintiff's economic loss can be caused by a misrepresentation "or other fraudulent conduct." 544 U.S. at 346. The MCFA likewise expands fraud beyond common law misrepresentation to include non-representational deceptive conduct.[18] Because Petitioners' MCFA loss need not be linked directly to Defendants' statements if Defendants engaged in deceptive conduct, *Dura* is inapplicable. *See Dura*, 544 U.S. at 346; *Enron*, 439

---

[18] Minn.Stat. §325F.69 prohibits the "act, use, or employment by any person of any fraud, ...misrepresentation, misleading statement *or deceptive practice....*"

F.Supp.2d at 713-14 (*Dura* "did not address an umbrella scheme involving secondary actors nor conduct under Rule 10b-5 (a) and (c)...but focused on the alleged misleading statements of [Dura's] own managers and officers").

The Eighth Circuit and *Dura*/PSLRA impose a far more burdensome causation standard than do the Minnesota courts. *See, e.g., LeSage v. Norwest Bank Calhoun-Isles*, 409 N.W.2d 536, 539 (Minn.App. 1987)(in an action against bank that vouched for soundness of notes issued by bank's borrower, summary judgment on common law fraud claim based on lack of proximate cause was irrelevant to MCFA, which is broader; investor's agreement to accept second note did not, as a matter of law, break the causal link between bank officer's representations that induced the purchase of the first note and the loss incurred on the second note); *Yarrington v. Solvay Pharmaceuticals, Inc.*, 2006 WL 2729463, *5 (Minn.App., Sept. 26, 2006) (causation sufficiently alleged where pharmaceutical company falsely implied drug was FDA-approved in description in *Physician's Desk Reference* and thus caused prescription of drug that harmed plaintiff); *Trenholme v. QRS Diagnostic, L.L.C.*, 2006 WL 2601664, *6-7 (Minn.App., Sept. 12, 2006) (rejects argument that defendant's nondisclosure regarding guarantor's financial capacity did not damage plaintiff); *Sutton v. Viking Oldsmobile Nissan, Inc.*, 2001 WL 856250, *2 (Minn.App., July 31, 2001)(auto dealer's omission of fact it was retaining part of proceeds for finance and insurance products was enough to establish causation where plaintiff testified he would have rejected deal with disclosure; as compared to common-law fraud causation, "the consumer fraud act requires the lesser standard of a legal nexus between the injury and wrongful conduct.")(*citing Group Health,* 621 N.W.2d at 14); *Baker v. Ploetz,* 597 N.W.2d 347, 352 (Minn.App.1999)(court rejected defendant's argument that third party's post-transaction involvement caused plaintiffs' loss, not defendant's fraud in inducing the transaction).

Refusing to accede to Minnesota caselaw, the Eighth Circuit says it is "not persuaded that the Minnesota legislature intended 'to provide investors with broad insurance against market losses,' rather than 'to protect them against those economic losses that misrepresentation actually cause.'" A-10, *citing Dura.* But the Minnesota Supreme Court has repeatedly said that the Minnesota legislature did "clearly intend[]" that a MCFA claim not require proof of the common law fraud elements, including direct common law fraud causation. The Eighth Circuit contradicts the broad construction of the MCFA required by the Minnesota legislature. Petitioners have clearly alleged "some causal nexus" between the undisclosed risks in November 1997 and investors' losses beginning in 1999, satisfying the MCFA's less onerous causation standard. *See Group Health,* 621 N.W.2d at 14 & 15 n.11.

D. Loss Causation Is Not an Element of Rescission.

The Eighth Circuit ignored Petitioners' argument that rescission, a remedy sought by Petitioners (*PA:121*), does not require Petitioners prove Defendants' fraud caused damages. *See Dupont v. Haggard,* 49 N.W.2d 186, 187 (Minn.1951) (fraud without damage will sustain an action for rescission); *Spies v. Brandt,* 41 N.W.2d 561, 568 (Minn.1950) ("[W]e are not concerned in an action for rescission with a question of damages."). Rescission is a remedy under the MCFA. Minn.Stat. § 8.31, subd. 3a.

In seeking rescission, Petitioners seek a constructive trust to be imposed on the debenture proceeds received by Heller. *Wright v. Wright*, 311 N.W.2d 484, 485 (Minn.1981)(using rescissory damages, the defrauding party holds the property in constructive trust for the defrauded transferor). Petitioners were fraudulently induced to purchase United's debentures, and the proceeds were paid directly to Heller, which perpetrated the fraud; Heller holds the debenture proceeds in constructive trust for the debentureholders. Rescissory damages contemplate a return to the *status quo ante* the wrongful conduct. *Reves,* 937 F.2d at 1335 n. 34.

III. The Eighth Circuit Erred in Holding that Heller Was Not Unjustly Enriched Because It Was Entitled to the Payments It Received from the Fraudulent Sale of Its Borrower's Debentures to Petitioners.

The Eighth Circuit ruled that a lender may deceive public investors to invest in the lender's debtor to improve the debtor's financial position to bring it into compliance with its loan covenants and repay the loan so long as that lender was entitled to the payments under its loan. A-14. The Eighth Circuit held that, because Heller was entitled to receive what it was paid pursuant to its contract with United, it was not liable for unjust enrichment for its deceit. *Id.* But Heller had no contract with the investors. While Heller was contractually entitled to the payments from United, it was not contractually entitled to any monies from the investors.

A party is "unjustly enriched in the sense that the term 'unjustly' could mean illegally or unlawfully" or that a party's conduct was "unconscionable by reason of a bad motive." *Park-Lake Car Wash, Inc. v. Springer,* 394 N.W.2d 505, 514 (Minn.App.1986). Unjust enrichment may be found where the person's conduct "has been unconscionable by reason of a bad motive, or where the result induced by his conduct will be unconscionable either in the benefit to himself or the injury to others." *Earle R. Hanson & Associates v. Farmers Cooperative Creamery Co.,* 403 F.2d 65, 70 (8th Cir.1968)(quoting *Johnson v. Freberg,* 228 N.W. 159 (1929)).

Heller's contractual right to loan payments from United did not give it license to deceive public investors, or to deceive the debenture underwriter to induce it to sell the debentures to public investors, or to otherwise employ deceit to enable United to obtain what United owed it. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. First Nat. Bank of Little Rock, Ark.,* 774 F.2d 909 (8th Cir.1985)(entitlement to payments received did not permit recipient to fraudulently obtain those payments).

To state a claim for unjust enrichment, "the plaintiff must plead more than that 'one party benefit[ted] from the efforts or obligations of others,' but instead must allege 'that a party was unjustly enriched in the sense that the term "unjustly" could mean illegally or unlawfully.' *First Nat'l Bank of St. Paul v. Ramier*, 311 N.W.2d 502, 504 (Minn. 1981)." A-14. By concealing United's breach of Heller's covenants that limited United's debt and ensured United's ability to service its debt, Heller induced Miller to underwrite United's debentures and enabled United to grossly misrepresent its loan compliance, which constituted illegal or unlawful conduct.

A claim for unjust enrichment is established where the plaintiff is able to "show that another party knowingly received something of value to which he was not entitled, and that the circumstances are such that it would be unjust for that person to retain the benefit." *Schumacher v. Schumacher,* 627 N.W.2d 725, 729 (Minn.App.2001) (citing *ServiceMaster of St. Cloud v. GAB Bus. Servs., Inc.,* 544 N.W.2d 302, 306 (Minn.1996)). An "unjust enrichment claim is most often an equity-based theory of quasi-contract wherein one party acts in a way patently unfair or unjust to the other party." *Wells Elec., Inc. v. Schaper,* 2006 WL 2807179, *6 (Minn.App., Oct. 3, 2006)(reversing summary judgment in favor of defendant based on an unjust enrichment theory that defendant may have benefited from an allegedly wrongfully obtained competitive advantage).

Under Minnesota law, Heller was unjustly enriched from the debenture offering proceeds when it deceived Miller. The issue is not whether Heller was entitled to have its loan repaid by United; rather, the issue is whether Heller could dupe public investors to enable United to make those payments out of deceptively procured proceeds. The Court wrongly held that a creditor may, without fear of civil liability, lie on behalf of its financially distressed debtor to induce a third party to invest in the debtor to bring the debtor into compliance with the creditor's financial covenants and to pay off the loan.

IV. The Eighth Circuit Erred in Holding Petitioners Have Not Alleged How Defendants Substantially Assisted United's Fraud.

The Eighth Circuit says that, because "United is alleged to have prepared its prospectus before seeking certificates from its lenders, [] the alleged concealment of the default could not have contributed to United's disclosures. In any event, the investors have not alleged how Heller and RFC substantially assisted any distinct fraud by United." A-13. The Eighth Circuit ignored Petitioners' very specific allegations of fraud and substantial assistance.

Petitioners alleged, in great detail, that United's debentures were fraudulently offered—e.g., the contrived measure of United's ability to service its debt and United's undisclosed chronically deficient capital, dependency on Defendants' loans to service the debentures, and other problems. *See supra.* The Eighth Circuit ignored Petitioners' allegations that Defendants substantially assisted the fraudulent offering. *PA:6-9[¶¶2-3, 15], 43-50[¶¶164-83], 51-53[¶¶196-200], 71-75[¶¶290-304], 91-94[¶¶409-25], 96[¶439], 116[¶¶527-28], 120[¶¶541-42].*

Because they had the prospectus, Defendants knew that it misrepresented United's compliance with their loan agreements. *PA:44[¶166], 74-75[¶301].* Defendants conditioned their 1997 default waivers—i.e., their agreement to continue lending—on United getting more capital, for which the prospectus was required, and monitored the offering's progress. *PA:104-07[¶¶472-97]. See Monsen v. Consolidated Dressed Beef Company*, 579 F.2d 793, 802-03 (3d Cir.1978)(bank aided and abetted where bank knew of, and conditioned its loan on the continuation of, note sales, knew of company's intent not to disclose notes' subordination to bank's loans, and required that company inform it of the sales). As in *Monsen*, Defendants substantially benefited from United's debenture sales, both by receiving the proceeds and by shifting the risk of United's excessive debt to debenture purchasers. *PA:56-57[¶¶213-19], 75[¶¶303-04], 107[¶¶492-93]*; 579 F.2d at 802-03 (bank enhanced its position at expense of noteholders with knowledge of company's deception of noteholders).

Petitioners allege Defendants were actively involved in perpetrating the fraud; without Defendants' false certificates the offering could not have gotten regulatory clearance and Miller could not have sold it. Defendants knew why Miller needed their certificates and intended their certificates to influence and enable Miller's decision to underwrite United's debentures. Petitioners purchased their debentures in transactions that Defendants pressured United to undertake, intended to influence, monitored, wanted to happen, and supplied false certificates to ensure it did happen. *PA:48-49[¶¶179-82], 73-75[¶¶299-302], 91-94[¶¶409-25], 97-98[¶¶442-46], 104-06[¶¶472-86]*. Defendants consciously intended to assist in the perpetration of the wrongful act—Defendants' actions were "accompanied by actual knowledge of the underlying fraud and intent to aid and abet a wrongful act." This, along with Defendants' active assistance, renders them liable. *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir.1985); Restatement (Second) of Torts §876.

That Defendants provided their certificates after the prospectus was "prepared" is irrelevant. *See A*-13. Defendants' certificates were sent *before* the Underwriting Agreement was executed, *before* any debentures were sold, *before* United represented to Miller at each closing that it was in compliance with Defendants' loans (which it could not have done without Defendants' certificates), and *before* the prospectus was distributed. *PA:13[¶¶27-30], 46[¶¶171-72], 56[¶216], 72[¶¶294-96], 92-94[¶¶412-25]*. Miller required Defendants' certificates to do the underwriting and would not have sold the debentures to its customers if it was told United was in default of Heller's and RFC's loan agreements. *PA:43-44[¶¶164-66], 51-53[¶¶196-99], 71-74[¶¶290-300], 91-94[¶¶409-25]*.

Defendants' certificates were not too late for United to amend the registration statement to include information that United was in default or for Miller to decide it was too risky to proceed with the offering. *PA:49[¶¶181-82], 53[¶200], 93-94[¶¶416-25]*. Having represented to the SEC that United was in compliance, United and Miller were seeking Defendants' assurance their representation was truthful or they would have had to inform the SEC otherwise. *PA:72[¶¶296], 91-92[¶¶409-11]*.

Without Defendants' fraudulent certificates, there would have been no debentures. Miller concealed United's defaults because Defendants falsely represented to Miller that United was not in default when it was. In neither *Metge* nor *Monsen* was the defendant lender's conduct the direct cause of plaintiffs' losses; in *Federal Deposit Insurance Corporation v. First Interstate Bank*, 885 F.2d 428 (8th Cir.1989), the defendant bank's proximate cause consisted of the provision of lawful banking services that were unlawfully used to victimize another bank. None of those defendants' conduct was as closely connected to the fraud as in this case. In none of those cases did the defendant make any representations or actively conceal any material facts as Defendants did here. As the requisite causal connection for aiding and abetting liability existed in those cases, it perforce exists here.

Minnesota law recognizes aiding and abetting liability. *Witzman v. Lehrman, Lehrman & Flom*, 601 N.W.2d 179, 186-87 (Minn.1999). The Eighth Circuit's decision effectively eliminates it.

CONCLUSION

The Eighth Circuit wrongly applied *Dura* loss causation to Minnesota statutory and common law fraud, and it applied *Dura* loss causation contrary to other Circuits. With barely a perfunctory nod in the direction of Minnesota law, the Court, contrary to well-established law and the Seventh and Tenth Amendments, replaced Minnesota statutory and common law fraud with a species of loss causation specific to federal securities statutes and completely ignored well-settled Minnesota and other Circuits' law that causation—especially intervening cause (about which the Court improperly speculated)—is for the jury to decide. The Court's decision and this petition raise significant questions about CAFA-conferred federal diversity jurisdiction over state law claims that are brought as class actions. The Court's application to state fraud claims of a loss causation standard dictated by a restrictive federal fraud statute exceeds the Court's and CAFA's constitutional limits under the Tenth Amendment. By ignoring Minnesota law and Petitioners' explicit allegations, the Court exceeded its jurisdiction and the authority of Rule 12(b)(6). By ruling on the likelihood of intervening cause without any consideration of allocation of fault between foreseeable and unforeseeable events, in complete contravention of Minnesota and other Circuits' law that such issues are for the jury to decide, the Court ignored the Seventh Amendment guaranteeing a jury trial. By brushing aside the critical differences between Petitioners' MCFA claim regarding proximate cause and the ostensible common law fraud source of *Dura's* notion of proximate cause as limited by the PSLRA, the Court eviscerated Minnesota's chosen means for protecting its citizens from fraud. This petition offers this Court the opportunity to caution federal courts that CAFA is not a license to replace the common and statutory fraud law of the states with a federal common law of fraud. For the foregoing reasons, Petitioners respectfully request the issuance of a writ of certiorari to the United States Court of Appeals for the Eighth Circuit.

Date: July 8, 2008 Respectfully submitted,

Vernon J. Vander Weide
Thomas V. Seifert
HEAD, SEIFERT &
VANDER WEIDE, P.A.
333 South Seventh Street, Suite 1140
Minneapolis, MN 55402-2422
Telephone: 612-339-1601
Fax: 612-339-3372

John A. Cochrane
COCHRANE & BRESNAHAN, P.A.
287 East 6th Street, Suite 262
St. Paul, MN 55101-1099
Telephone: 651-298-1950
Fax: 651-298-0089

ATTORNEYS FOR PETITIONERS

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No: 06-3694

Vernon Schaaf, et al.,

Appellants,

Residential Funding Corporation and Heller Financial, Inc.,

Appellees,

Marshall & Isley Bank,
State of Minnesota.

Amicus on Behalf of Appellant.

Appeal from U.S. District Court for the District of Minnesota – Minneapolis

---

ORDER

The petition for rehearing en banc is denied.
The petition for rehearing by the panel is also denied.

April 09, 2008.

Order Entered at the Direction of the Court:

s/
Clerk,
U.S. Court of Appeals, Eighth Circuit.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 06-3694

Vernon Schaaf; Julian Boik; *
Alfred Streufert, on behalf of *
themselves and others similarly *
situated, *
Plaintiffs/Appellants, *
*
v. * Appeal from the
Residential Funding * United States
Corporation, * District Court
* for the
* District
* of Minnesota.
Heller Financial, Inc., *
Defendants/Appellees, *
*
Marshall & Isley Bank, *
Defendant. *

Submitted: April 12, 2007 Filed: February 22, 2008

Before WOLLMAN, BEAM, and COLLOTON, Circuit Judges.

COLLOTON, Circuit Judge.

Investors Vernon Schaaf, Julian Boik, and Alfred Streufert appeal the district court's[1] dismissal of their claims against Residential Funding Corporation (RFC) and Heller Financial, Inc. The district court concluded that the investors failed to plead a sufficient causal nexus between their financial losses and the allegedly fraudulent actions of RFC and Heller. Alternatively, the district court rejected the investors' common law fraud claims because they failed to allege reliance, and dismissed their claims under the Minnesota Consumer Fraud Act (MCFA) because those claims did not seek to secure a public benefit. We affirm based on the first ground.

---

[1] The Honorable Joan N. Ericksen, United States District Judge for the District of Minnesota, adopting the report and

I.

We recite the facts according the allegations of the investors' complaint. In November 1997, United Homes, Inc., issued debentures worth about $7,000,000, which paid 11% annual interest. According to the offering's prospectus, United intended to use the proceeds to pay off a $2.6 million line of credit bearing an interest rate of 25%, while using the remainder to pay off debt to Heller (which bore a rate of 9.4% on June 30, 1997) and RFC (9.75% on June 30, 1997). Before allowing United to proceed with the offering, the Securities and Exchange Commission (SEC) required United to disclose in its prospectus the amount of its debt to Heller and RFC, and whether United was in compliance with the terms of this debt. Without contacting either lender to confirm that it actually was in compliance, United modified the prospectus to indicate its supposed compliance with the terms of its indebtedness to Heller and RFC. Several weeks later, United

---

recommendation of the Honorable Susan Richard Nelson, United States Magistrate Judge for the District of Minnesota.

requested lenders' certificates from Heller and RFC indicating that United was in compliance with the terms of its debt.

On November 14, 1997, the SEC declared United's prospectus "effective," meaning that the offering's underwriter could begin selling the securities. *See* 15 U. S. C. § 77e. After the prospectus was deemed effective, but before United had hired an underwriter, RFC and Heller provided certificates indicating that United was not in default. The plaintiffs allege that both certificates were fraudulent because United had triggered defaults by violating its debt-to-worth covenant with each lender.

A day after receiving the lenders' certificates, United entered into an underwriting agreement with Miller & Schroeder Financial (M & S). The underwriting agreement required United to represent to M & S that neither United nor any subsidiary of United was "in default with respect to any provision of any . . . loan agreement . . . to which it [was] a party or by which it may be bound." After receiving this assurance, M & S went ahead with the offering. The investors allege that M & S would not have proceeded had it known that United was in violation of its debt-toworth covenants with its lenders. They also allege that Heller and RFC recognized that M & S would rely on the lenders' certificates. The plaintiffs maintain that if M & S had refused to proceed with the offering, then the plaintiffs could not have purchased the securities and would not have suffered the ensuing financial losses.

The offering began on November 25, 1997, and extended into 1998. The plaintiffs purchased debentures in November and December 1997 based on M & S's oral representations that the debentures were "worthy investments for investors seeking income investments." Each plaintiff received a prospectus along with his purchase.

In April 1998, Heller declared United in default of its credit agreement for failing to comply with the agreement's reporting requirements. This declaration terminated United's revolving line of credit with Heller.

On November 16, 1998, RFC informed United that United had violated the loan agreement's debt-to-worth requirement, the same covenant that the plaintiffs allege was the subject of the fraudulent lenders' certificates. For a short time, United and RFC amended the loan agreement to remedy the default. In February 1999, however, RFC declared that United's loans were "presently in default and accordingly RFC is entitled to withhold further disbursement and to exercise its rights and remedies under the Loan Documents." Citing a "severe cash flow shortage" at United, RFC sought to extricate itself from the relationship. Still, RFC did not foreclose on its collateral at this point. It held out hope that United could improve its financial position by selling off assets or issuing equity. Later, in June 1999, when United requested RFC's permission to pay interest on the debentures using RFC's funds, RFC refused, declaring that it would allow United to use its RFC credit line only to fund expenses that would "directly result in the completion of partially built houses forming part of [RFC's] collateral." On February 8, 2000, RFC foreclosed on its loans to

United, writing that "Events of Default are numerous and include, but are certainly not limited to, the fact that interest on the loans has not been paid since December, 1998."

The source of United's "severe cash flow shortage" was the poor performance of some of its business ventures. In the fall of 1998, United failed to sell as many homes as anticipated. In this period, "United's Arizona activities . . . performed poorly . . . due to a number of local factors including specific project locations, zoning issues, and personnel issues." These business failures cascaded because of United's heavy debt load. When United's creditors refused to advance new lines of credit, United was doomed to insolvency. On March 9, 2000, after a credit line with National City Bank finally dried up, United filed its petition for bankruptcy, making the debentures worthless.

The plaintiffs first sued M & S under the federal Securities Act of 1933, 15 U.S.C. §§ 77k, 77l, and the Minnesota Securities Act, Minn. Stat. § 80A.40 *et seq.* In that suit, the state trial court refused to certify a class proposed by the plaintiffs, and M & S later declared bankruptcy. The plaintiffs commenced this suit in state court against Heller and RFC, asserting violations of the MCFA and claims of common law fraud and unjust enrichment. Heller and RFC removed the case to the district court, which dismissed the plaintiffs' claims. The district court adopted the report and recommendation of a magistrate judge, which concluded that the plaintiffs had failed to plead a sufficient causal nexus between their injuries and the allegedly fraudulent lenders' certificates. Alternatively, the district court concluded that the plaintiffs' MCFA claims did not satisfy the statute's requirement that such claims seek to secure a "public benefit." The court also rejected plaintiffs' common law fraud claims on the ground that they had failed to allege that they relied on Heller and RFC's fraudulent lenders' certificates.

II.

On appeal, the investors argue that the district court erred in dismissing their claims on the ground that they failed to allege loss causation in their complaint. In addition, they maintain that their MCFA claim provided sufficient public benefit to satisfy the requirements of the statute, and that they adequately alleged reliance for their common law fraud claims. The investors also appeal the district court's dismissal of their aiding and abetting claims against Heller and RFC, as well as the court's dismissal of their claim against Heller for unjust enrichment.

A.

We review the district court's grant of a motion to dismiss *de novo*. *In re Canadian Import Antitrust Litig.*, 470 F.3d 785, 788 (8th Cir. 2006). Dismissal is proper where the plaintiffs' complaint fails to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6). At this stage of the litigation, we accept as true all of the factual allegations contained in the complaint, and review the complaint to determine whether its allegations show that the pleader is entitled to relief. *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955, 1964-65 (2007); Fed. R. Civ. P. 8(a)(2). The plaintiffs need not provide specific facts in support of their allegations, *Erickson v. Pardus,* 127 S. Ct. 2197, 2200 (2007) (per curiam), but they must include sufficient factual information to provide the "grounds" on which the claim rests, and to raise a right to relief above a speculative level. *Twombly,* 127 S. Ct. at 1964-65 & n.3. The complaint must "provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind." *Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336, 347 (2005). Otherwise, a plaintiff with no hope of showing proximate causation could require inefficient expenditure of resources and potentially induce a defendant to settle a meritless claim. *Id.*

To prevail on a tort claim, a plaintiff must show that the defendant's tortious actions caused the plaintiff's losses. W. Page Keeton et al., *Prosser and Keeton on Torts* § 41 (5th ed. 1984). When ruling on a motion to dismiss, we look to whether the plaintiffs' allegations suffice to show the required causal connection between the defendant's wrongful conduct and the plaintiffs' losses. *Dura,* 544 U.S. at 347. In the securities context, this requirement means that the plaintiff must adequately plead both "transaction causation" and "loss causation." *Harris v. Union Elec. Co.,* 787 F.2d 355, 367 (8th Cir. 1986); *Lentell v. Merrill Lynch & Co., Inc.,* 396 F.3d 161, 172 (2d Cir. 2005); *Specialized Tours, Inc. v. Hagen,* 392 N.W.2d 520, 538 (Minn. 1986). To prove transaction causation, the plaintiff must show that the defendant's fraud induced the plaintiff to purchase the security. *Harris,* 787 F.2d at 367. Put another way, the plaintiff must show that but for the misrepresentation, he would not have purchased the security. Loss causation, on the other hand, corresponds to the common law's requirement of proximate causation. *Lentell,* 396 F.3d at 172-73; *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.,* 343 F.3d 189, 197 (2d Cir. 2003). This doctrine requires the plaintiff to prove "a causal connection between the material misrepresentations and the loss." *Dura,* 544 U.S. at 342.

Though loss causation is an "exotic name" for this concept, the standard does not differ from that employed in a common law fraud case. *Bastian v. Petren Res. Corp.,* 892 F.2d 680, 683-85 (7th Cir. 1990). Unless the plaintiff can show that the defendant's fraud caused his loss, he cannot recover *See Dura,* 544 U.S. at 343-44.

In a securities case, this standard requires the plaintiff to show that the defendant's fraud – and not other events – caused the security's drop in price. *See Specialized Tours,* 392 N.W.2d at 537 (quoting *Prosser and Keeton on the Law of Torts* § 110, at 767). This is because the security's "lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price." *Dura,* 544 U.S. at 343. Thus, to recover for securities fraud at common law and under SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, the plaintiff must show "that the loss [was] foreseeable *and* that the loss [was] caused by the materialization of the concealed risk." *Lentell,* 396 F.3d at 173 (emphasis in original).

The district court applied this standard to the plaintiffs' common law fraud claims and their claims under the MCFA. The investors and the Attorney General of Minnesota, as *amicus curiae,* argue that the common law requirement of loss causation does not apply to claims under the MCFA, which they say has a more permissive standard for showing causation.

To assert a remedy for damages arising out of a violation of the MCFA, Minnesota law requires that a private plaintiff be "injured by" the violation. Minn. Stat. § 8.3 1, subd. 3a. In *Group Health Plan, Inc. v. Philip Morris Inc.,* 621 N.W.2d 2 (Minn. 2001), the Supreme Court of Minnesota addressed how a plaintiff could prove that it had been "injured by" a violation of the State's consumer protection laws. Several health maintenance organizations (HMOs) brought suit against cigarette manufacturers in federal court, asserting that the tobacco companies had marketed their products unlawfully, leading to greater costs to the insurers. The manufacturers' marketing, and their discouragement of tobacco education programs, allegedly had induced plan members to consume more tobacco products, thus increasing the HMOs' costs. In defense, the tobacco companies argued that the HMOs could not prove that they had been injured by the violations of the MCFA without showing that the misrepresentations actually induced particular plan members to consume more tobacco products.

The federal district court certified this question of state law to the Supreme Court of Minnesota. That court opined that "it is not necessary to plead *individual consumer reliance* on the defendant's wrongful conduct to state a claim for damages" under the MCFA, because the legislature had "eliminated the requirement of pleading and proving traditional common law reliance as an element of a statutory misrepresentation in a sales action." *Id.* at 13 (emphasis added). Nevertheless, the court declared that "causation remains an element of such a claim," and that it would be necessary for the plaintiffs to prove reliance on the defendants' statements or conduct to satisfy the causation requirement. *Id.* In the tobacco case before it, the court stated that "the showing of reliance that must be made to prove a causal nexus need not include direct evidence of reliance by individual consumers of defendants' products." *Id.* at 14. Rather, the court explained that "the causal nexus and its reliance component" could be established by "direct or circumstantial evidence that . . . is relevant and probative as to the relationship between the claimed damages and the alleged prohibited conduct." *Id.*

The investors argue that *Group Health* relaxed the common law's causation requirements, and that the MCFA does not require the investors to satisfy the loss causation standard applied by the district court. Although the investors appeared to concede in the district court that they must prove loss causation, (R. Doc. 59, at 35), they now seem to argue that loss causation is not required at all, and that they may prevail merely upon a showing of transaction causation. (Appellants' Br. 25; Reply Br. 9). We reject this far-reaching contention.

Group Health shows that the MCFA relaxes the common-law standard for proving reliance, which is one element of common-law causation. In the securities context, reliance is another way of describing transaction causation, *Harris,* 787 F.2d at 366, and *Group Health* continues to require proof of reliance under the MCFA. The relaxation of proof required to establish reliance or transaction causation, moreover, does not eliminate the need for a plaintiff to prove that the defendants proximately caused his financial loss. As *Group Health* recognized, the MCFA provides a remedy only to those actually "injured by" the wrongdoer's misconduct. Minn. Stat. § 8.31, subd. 3a. This limitation would be virtually meaningless if there were no requirement to show proximate loss causation. While the MCFA in some respects is designed "to make it easier to sue for consumer fraud than it had been to sue for fraud at common law," *Wiegand v. Walser Auto Groups, Inc.*, 683 N.W.2d 807, 812 (Minn. 2004), we are not persuaded that the Minnesota legislature intended "to provide investors with broad insurance against market losses," rather than "to protect them against those economic losses that misrepresentations actually cause." *Dura,* 544 U.S. at 345.

The state attorney general appears to acknowledge that the plaintiffs must show some degree of loss causation, but contends that the *Dura* standard for federal securities cases, which requires a "causal connection" between the material representation and the loss, 544 U. S. at 342, is "more burdensome" than the standards of "legal nexus" or "causal nexus" that Minnesota courts have applied under the MCFA. We are not persuaded that there is a difference between a "legal nexus," "causal nexus," and "causal connection" for purposes of showing loss causation. *Group Health* established that plaintiffs in at least certain cases are not required to present "direct evidence of reliance" by individual customers, but the court was clear to say that "causation is a necessary element in a damages claim" under the MCFA. 621 N.W.2d at 14. And the Supreme Court of Minnesota favorably cited our court's opinion in *In re Control Data Corp. Securities Litigation,* 933 F.2d 616, 619 (8th Cir. 1991), for the proposition that "some causal nexus" is required between the conduct of the defendant and the change in market price that damaged the plaintiff. *Group Health,* 621 N.W.2d at 14. *Control Data Corp.,* in turn, followed the earlier precedent of *Harris v. Union Electric Co.,* which specifically required a plaintiff to prove traditional "loss causation." *See Harris,* 787 F.2d at 366 (citing *Wilson v. Comtech Telecomm. Corp.,* 648 F.2d 88, 92 n.7 (2d Cir. 1981); *Huddleston v. Herman & MacLean,* 640 F.2d 534, 549 & n.24 (5th Cir. 1981), *aff'd in part and rev'd in part on other grounds,* 459 U.S. 375 (1983)).

Our understanding of the MCFA thus conforms to federal law dealing with claims for securities fraud. Although a plaintiff must show both transaction causation and loss causation, the courts presume transaction causation when an investor buys or sells stock at a price set by a liquid market in reliance on the integrity of that price. *Basic Inc. v. Levinson,* 485 U.S. 224, 247 (1988) ("Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action."). Nevertheless, this reduced standard for pleading reliance does not relieve the plaintiff of his burden of pleading loss causation. *Dura,* for example, was a "fraud on the market" case in which the Court cited the nonconclusive presumption of reliance on the alleged misrepresentations, 544 U.S. at 341-42, but nonetheless required the plaintiffs to plead loss causation to survive a motion to dismiss.

We thus conclude that the MCFA's requirement that a plaintiff be "injured by" conduct of the defendant does not allow for recovery unless a plaintiff can show that the defendant's actions proximately caused the plaintiff's losses. Because *Dura* and other federal cases address the standard for proximate causation in cases of securities fraud, we find them instructive. To prevail, the plaintiffs must plead and prove that the loss was foreseeable and caused by the materialization of the concealed risk. *Lentell,* 396 F.3d at 173.

The complaint in this case does not sufficiently allege proximate causation. The investors argue that Heller and RFC concealed United's default and the risk that Heller and RFC could declare a default based on United's violation of its debt-to-worth covenants. They contend that they were injured when this risk materialized. But the investors cannot have been "injured by" this nondisclosure, because there is no allegation that either lender acted upon United's violation of the debt-to-equity covenants in November 1997 in a way that harmed United or its debenture-holders. Heller allegedly declared United in default in April 1998 because of United's failure to comply with the loan's reporting requirements. RFC cited United's failure to pay interest on RFC's loans as its primary example of numerous default events before foreclosing on the loan's collateral. Thus, the investors' losses were not "caused by the materialization of the concealed risk" that Heller and RFC would declare a default because of United's breach of its debt-to-worth covenants in 1997. *See Lentell,* 396 F.3d at 173. Rather, United's failure to deliver financial information to Heller caused Heller to declare United in default, and United's failure to pay interest on its loans caused RFC to foreclose on the loans.

With respect to RFC only, rather than rely solely on RFC's foreclosure on the loans in 2000, the plaintiffs seek to connect their injury to a November 1998 letter from RFC to United. This letter noted that United was in default because of its breach of its debt-to-worth covenant – the same covenant that was the subject of the default that RFC allegedly concealed in 1997. The investors argue that this November 1998 notification caused their damages, because in June 1999, RFC refused to lend United funds to pay interest on the debentures. But plaintiffs have not adequately alleged how RFC's 1998 letter, or the breach it recognized, *caused* RFC to stop lending money to United. According to the investors' allegations, RFC knew that United was in breach of its debt-to-worth covenant since November 1997, but the complaint alleges that RFC's critical refusal to lend occurred later, in June 1999. Thus, United's default on the debt-to-worth covenant, in and of itself, cannot have caused RFC to discontinue the necessary lending to United.

The passage of time between the November 1997 lenders' certificates and United's bankruptcy in March 2000 further demonstrates the inadequacy of the complaint. The *Dura* court noted that "the longer the time between purchase and sale, . . . the more likely that other factors caused the loss." *Dura,* 544 U.S. at 343. The passage of time in this case is particularly significant, because the complaint alleges that United suffered from poor home sales in the fall of 1998, which caused slowdowns in production and closings, which in turn reduced the availability of cash to United. The *Dura* court noted that such a change in economic circumstances could defeat a plaintiff's attempt to prove loss causation and give added significance to the passage of time. *Id.* at 342-43.

Because we conclude that the district court properly dismissed the common-law fraud claims and the MCFA claims for failure adequately to allege loss causation, we need not address whether the debentures were "merchandise" under the MCFA, or whether the investors' complaint alleges a "public benefit." We also need not consider whether the plaintiffs' allegations of reliance suffice to state a claim for common law fraud.

B.

The investors next argue that Heller and RFC aided and abetted United and M & S in their scheme to defraud the investors. Because we conclude that allegedly concealing the 1997 defaults could not have proximately caused the investors' losses, we similarly conclude that any misrepresentation about these defaults by United or M & S could not have caused the plaintiffs' losses. United is alleged to have prepared its prospectus before seeking certificates from its lenders, so the alleged concealment of the default could not have contributed to United's disclosures. In any event, the investors have not alleged how Heller and RFC substantially assisted any distinct fraud by United. Therefore, the district court properly dismissed the aiding and abetting claim. *See Metge v. Baehler,* 762 F.2d 621, 624 (8th Cir. 1985); Restatement (Second) of Torts § 876.

C.

The investors also argue that the district court erroneously dismissed their claim for unjust enrichment against Heller. The plaintiffs allege that United used the proceeds of the offering to pay off some of its debt to Heller, and that these proceeds unjustly enriched Heller. The district court concluded that without valid fraud claims, the investors could not recover for unjust enrichment.

To establish a claim for unjust enrichment under Minnesota law, the plaintiff must "show that the defendant has knowingly received or obtained something of value for which the defendant 'in equity and good conscience' should pay." *ServiceMaster of St. Cloud v. GAB Bus. Servs., Inc.,* 544 N.W.2d 302, 306 (Minn. 1996) (quoting *Klass v. Twin City Fed. Sav. And Loan Ass'n,* 190 N.W.2d 493, 494-95 (Minn. 1971)). "The theory of unjust enrichment is based on what the person allegedly enriched has received, not on what the opposing party has lost." *Georgopolis v. George,* 54 N.W.2d 137, 142 (Minn. 1952). Thus, to state a claim, the plaintiff must plead more than that "one party benefit[ted] from the efforts or obligations of others," but instead must allege "that a party was unjustly enriched in the sense that the term 'unjustly' could mean illegally or unlawfully." *First Nat'l Bank of St. Paul v. Ramier,* 311 N.W.2d 502, 504 (Minn. 1981). Thus, unjust enrichment does not occur when a defendant "is enriched by what he is entitled to under a contract or otherwise." 1 Dan B. Dobbs, *Law of Remedies* § 4.1(2), at 558 (2d ed. 1993).

Here, the investors have failed to allege that Heller was not entitled to the proceeds it received from United. Indeed, they admit that Heller *was* entitled to these funds, stating in their complaint that these funds enabled United to reduce its debt to Heller by half. The loan agreement between United and Heller provided a contractual basis for Heller's receipt of the funds. Hence, the district court properly dismissed the investors' claim for unjust enrichment.

For the foregoing reasons, the judgment of the district court is affirmed.

United States District Court
District of Minnesota

Vernon SCHAAF, Julian Boik, and Alfred Streufert, on behalf of themselves and others similarly situated, Plaintiffs,

v.

RESIDENTIAL FUNDING CORPORATION and Heller Financial, Inc., Defendants, And Marshall & Isley Bank, Nominal Defendant.

Civ. No. 05-1319 (JNE/SRN).

Aug. 29, 2006.

John A. Cochrane, Esq., and Vernon J. Vander Weide, Esq., on behalf of Plaintiffs.
Andrew J. Holly, Esq., and James K. Langdon, Esq., on behalf of Defendant Residential Funding Corporation.
Larry D. Espel, Esq., and Monte A. Mills, Esq., on behalf of Defendant Heller Financial, Inc.

ORDER

JOAN N. ERICKSEN, District Judge.

In a Report and Recommendation dated July 27, 2006, the Honorable Susan Richard Nelson, United States Magistrate Judge, recommended that Defendants' Motion to Dismiss and/or Strike be granted and that Plaintiffs' claims be dismissed. Plaintiffs objected to the Report and Recommendation. The Court has conducted a de novo review of the record. Based on that review, the Court adopts the Report and Recommendation. Therefore, IT IS ORDERED THAT:

1. Defendants' Motion to Dismiss and/or Strike [Docket No. 33] is GRANTED.

2. Plaintiffs' Complaint is DISMISSED.
SUSAN RICHARD NELSON, United States Magistrate Judge.

REPORT AND RECOMMENDATION

The above-captioned matter comes before the undersigned on Defendants' Motion to Dismiss and/or Strike (Doc. No. 33). This matter has been referred to the undersigned for resolution of pretrial matters pursuant to 28 U.S.C. § 636 and Local Rule 72.1. For the reasons set forth below, the Court recommends granting Defendants' motion and dismissing all of Plaintiffs' claims for failure to state a claim upon which relief may be granted.

I. BACKGROUND

From November 1997 until November 1999, Plaintiffs and members of the class they seek to represent were solicited and allegedly induced by underwriter Miller & Schroeder Financial, Inc. (MSF) to purchase debentures[1] issued by United Homes, Inc. (UHI).

---

[1] Debentures are investments in which the purchasers make a loan to the issuing company in exchange for the subsequent return of the principal amount with interest. (*Id.* ¶ 22.)

(Compl.¶ 1.) On September 25, 1997, before the solicitation began, the Securities and Exchange Commission (SEC) told UHI to include a disclosure in the required prospectus for its debentures stating whether UHI was in compliance with its loan agreements with UHI's primary lenders: Residential Funding Corporation (RFC) and Heller Financial, Inc. (Heller). (*Id.* ¶ 409.) On October 17, 1997, UHI informed the SEC that "[d]isclosure has been added to ... the [p]rospectus indicating the amount of debt outstanding under the Heller Line and the [RFC] Line as well as the fact that [UHI] is in compliance with the terms of this indebtedness."(*Id.* ¶ 410.) On November 5 and 10, 1997, UHI informed Heller and RFC that needed compliance certificates for their respective loan agreements. (*Id.* ¶ 412.) On November 14, 1997, the SEC declared effective the registration statement, including the prospectus, for the UHI debentures. (*Id.* ¶ 19.) That prospectus included a statement by UHI that it was "in compliance with the terms of the credit agreements governing [UHI's] indebtedness."(*Id.* ¶ 32.)

On November 18, 1997, RFC sent a lender certificate to UHI and MSF in which RFC stated that it was "not aware of any facts that would reasonably give rise" to a concern that UHI would default on its existing loans with RFC. (*Id.* ¶ 292-93.) On the same day, Heller provided UHI and MSF with a similar lender certificate. (*Id.* ¶ 168.) Under the credit agreement between UHI and Heller, Heller's consent was required for UHI to sell the debentures at issue in this litigation. (*Id.* ¶ 207.) On November 19, 1997, UHI entered into an underwriting agreement with MSF, in which UHI was required to represent to MSF that UHI was not in default or breach of any loan agreement and that no fact existed "which, with giving of notice or lapse of time or both, would constitute such an event of default."(*Id.* ¶ 413.)

The offering of the UHI debentures commenced on November 25, 1997 and extended into 1998. (*Id.* ¶ 418.) From November 20 through December 24, 1997, based solely upon oral representations made by MSF, the named Plaintiffs purchased the UHI debentures. (*Id.* ¶¶ 23-25, 49.) Only after Plaintiffs made their investment decisions, based on MSF's oral representations that the debentures were worthy investments, were they sent the written prospectus. (*Id.* ¶ 49.)

UHI's debentures were to be repaid in installments from September 1999 through March 2005. (*Id.* ¶ 22.) In April 1998, Heller informed UHI that UHI was in default due to UHI's failure to comply with the reporting requirements contained in the UHI-Heller lending agreement. (*Id.* ¶ 226.) In November 1998, RFC declared UHI in default of its loan terms. (*Id.* ¶ 382.) On March 9, 2000, UHI filed for bankruptcy. (*Id.* ¶ 518.) In November 2000, counsel for Plaintiffs filed an action in Minnesota state court captioned, *First National Bank of the North Prairie, Prairie National Bank, and Centennial National Bank v. Miller and Schroeder Financial, Inc.* (Doc. No. 44 Ex. A.) The plaintiffs in that action sued MSF on behalf of a class of investors concerning the same debentures at issue in this case for negligence, negligent misrepresentation, and violations of the Minnesota Securities Act, the Minnesota Consumer Fraud Act, and the federal Securities Act of 1933. (*Id.*

Ex. A.) The state trial court later denied those plaintiffs' attempt to certify the class (Doc. No. 50 Ex. E) and the individual plaintiffs settled their dispute with MSF shortly thereafter. MSF is now also bankrupt. (*Id.* ¶ 11). According to Plaintiffs, Heller received "all, or virtually all, of the net proceeds" of the debenture offering. (*Id.* ¶ 545.)Thus, Plaintiffs have no further recourse against UHI or MSF for the, now, worthless debentures. On June 10, 2005, Plaintiffs commenced an action against RFC and Heller in Minnesota state court. (Doc. No. 1 .) Defendants removed the case to this Court on July 1, 2005.(*Id.*) Plaintiffs' 549-paragraph Complaint is 116 pages in length, not including its appendix. (*See* Doc. No. 1 Exs. A-1, A-2, and A-3.)

Plaintiffs allege that UHI and MSF represented to the SEC that UHI was in full compliance with the loan covenants in its RFC and Heller loan agreements based upon false representations made by RFC and Heller in the 1997 lender certificates provided to MSF and UHI. (Compl.¶ 1.) Plaintiffs allege that Defendants' lender certificates were false when forwarded to MSF and UHI on November 18, 1997. (Doc. No. 59 at 5.)[2] According to Plaintiffs, "from September 30, 1996 through September 30, 1998, [UHI] "was in default of the maximum debt/worth ratio allowed by Defendants' loan agreements, as well as other covenants."(*Id.*) Plaintiffs allege that UHI issued its debentures to raise cash and Defendants allowed UHI to do so subject to subordinating the debentures to their loans. (*Id.* at 6.) Plaintiffs allege that the RFC and Heller certificate misrepresentations were repeated in the prospectus used to register UHI's debentures with the SEC and various states and to sell UHI's debentures to public investors. (*Id.* at 9.) According to Plaintiffs, MSF relied on RFC's and Heller's lender certificates in determining whether to underwrite UHI's debentures and, had MSF been aware that UHI was in violation of the RFC and Heller loan agreements, MSF would not have underwritten the debentures or would have conditioned its underwriting on UHI resolving the violations. (Compl.¶¶ 415-16.) Plaintiffs specifically allege that "[a]s MSF's chief executive officer testified, MSF would not have sold these debentures if" MSF knew that "UHI's senior lenders were able to put UHI in default of their loans."(*Id.* ¶ 414.)According to Plaintiffs, after the sale of the debentures, Defendants stopped accommodating UHI. (Doc. No. 59 at 8.) "By letter dated April 22, 1998, Heller informed UHI that UHI was in default due to UHI's failure to comply with the ... [quarterly reporting requirements] and other covenants" in its credit agreement with Heller. (Compl. ¶ 226.) Likewise, on "November 16, 1998, RFC informed UHI that UHI was in violation of the RFC debt/worth ratio."(*Id.* ¶ 382.)

---

[2] On May 2, 2006, Plaintiffs filed with the Clerk of Court a seventy-nine page responsive brief using the Court's electronic case filing system. (Doc. No. 59.) That same day, the Court received a courtesy "copy" of Plaintiffs' brief which numbers fifty-one pages and contains different text on a number of pages. Herein, the Court cites to the official version of the brief filed with the Clerk of Court.

Plaintiffs allege that RFC and Heller materially participated in, aided and abetted, and assisted, MSF's and UHI's fraudulent and deceptive conduct by representing to UHI, MSF, the SEC and, indirectly through MSF and the UHI debenture prospectus, to prospective purchasers of the UHI debentures, that UHI was in compliance with the applicable loan agreements. (*Id.* ¶¶ 2-3.)Plaintiffs' Complaint contains three counts: Count I alleges that RFC and Heller violated the Minnesota Consumer Fraud Act (MCFA), the relevant provision of which is codified at Minn.Stat. §§ 8.31, 325F.69; Count II alleges that RFC and Heller committed common law fraud; and Count III alleges that Heller was unjustly enriched by its conduct. (*Id.* ¶¶ 519-49.)As part of its statutory and common law fraud counts, Plaintiffs also claim that RFC and Heller aided and abetted the fraud allegedly perpetrated by UHI and MSF. (*Id.* ¶¶ 527-28, 541-42.)On pages five and six of their Complaint, Plaintiffs state that they seek to represent:

> a class that includes all persons who purchased the Debentures in a public offering pursuant to a registration statement with the SEC and various states that began on November 25, 1997 and, based on MSF's practice of allowing purchasers to rescind their purchases and reselling the Debentures whose purchases were rescinded, continued thereafter until November 1999....

(*Id.*Part IV ¶ 14.) Plaintiffs claim that there exist at least eight questions of law and fact common to this class. (*Id.* Part IV ¶ 15.) Plaintiffs also allege eight reasons why the action is properly maintained as a class action. (*Id.* Part IV ¶ 16.)

Defendants now move to dismiss all of Plaintiffs' claims pursuant to Federal Rule of Civil Procedure 12(b)(6), or, in the alternative, move to dismiss the class allegations set forth on pages five and six of the Complaint on the grounds that Plaintiffs cannot establish a maintainable class and finally seek to strike certain references in the Complaint as "immaterial and impertinent" allegations. (Doc. No. 33.)

II. PARTIES' POSITIONS

A. *Minnesota Consumer Fraud Act Claims Against RFC and Heller (Count 1)*

Defendants attack Plaintiffs' statutory fraud count by arguing that: (1) the MCFA applies only to ordinary consumer transactions concerning "merchandise," a term which is defined under the MCFA as "any objects, wares, goods, commodities, intangibles, real estate, loans, or services" and which the Minnesota Court of Appeals has determined does not include securities such as debentures; (2) the MCFA is a private attorney general statute and the Minnesota Supreme Court has determined that claims brought thereunder must demonstrate a benefit to the public, yet no public benefit is alleged by Plaintiffs; (3) no causal nexus exists between the fraud alleged and Plaintiffs' loss and this nexus is a required element of an MCFA claim; and (4) Plaintiffs' aiding and abetting claims fail because the Complaint fails to allege facts sufficient to show that RFC and Heller provided "substantial assistance" to UHI or MSF or acted in concert with UHI or MSF pursuant to a common scheme and such assistance is required to prove aiding and abetting. (Doc. No. 39 at 5-8, 20-29; Doc. No. 42 at 10-15.)

1. *Whether Securities Are Covered by the MCFA*

Defendants first contend that the Minnesota Court of Appeals, in *Loop Corp. v. McIlroy*, No. A04-362, 2004 WL 2221619, at *6 (Minn.Ct.App. Oct. 5, 2004), *rev. denied* (Minn. Dec. 22, 2004), confirmed that the term "merchandise," to which the MCFA exclusively applies, does not include securities such as debentures. (Doc. No. 39 at 6.) Defendants also contend that courts have held that the consumer fraud statutes of other jurisdictions which are similar or nearly identical to the MCFA do not apply to securities. (*Id.* at 6-7.) Finally, Defendants argue that Minnesota has enacted a separate legislative scheme, the Minnesota Securities Act, to cover securities fraud, which demonstrates that the legislature intended the MCFA to be limited to "ordinary consumer transactions." (*Id.* at 5-7.)

Plaintiffs agree that the UHI debentures are securities but respond that the *Loop* case cited by Defendants is an unpublished Minnesota Court of Appeals case and that the Minnesota Supreme Court in *Jenson v. Touche Ross & Co.*, 335 N.W.2d 720, 728 (Minn.1983) determined that the investment contracts at issue were covered by the MCFA. (Doc. No. 59 at 13.) At the motion hearing, Plaintiffs cited to *Force v. ITT Hartford Life and Annuity Insurance Co.*, 4 F.Supp.2d 843 (D.Minn.1998) and *Parkhill v. Minnesota Mutual Life Insurance Co.*, 995 F.Supp. 983 (D.Minn.1998) for the proposition that life insurance policies marketed as investments were covered by the MCFA. Plaintiffs also cite *Meyer v. Dygert*, 156 F.Supp.2d 1081 (D.Minn.2001) in support of their position, in which the court found the MCFA applicable to fraud involving junior mortgage notes and *State ex rel. Spannaus v. Coin Wholesalers, Inc.*, 250 N.W.2d 583, 584-85 (Minn.1976) in which the State of Minnesota alleged violations of the false advertising provision of the MCFA against certain persons concerning the sale of securities. (*Id.* at 13.)Plaintiffs argue that the term "merchandise" is defined in the MCFA to include "intangibles" and "loans," terms they claim cover the debentures at issue here. (*Id.* at 14.)Specifically, Plaintiffs contend that the United States and Minnesota Supreme Courts have construed bonds and notes to be "intangible" personal property. (*Id.* at 13.)Plaintiffs further point to the consumer fraud protections provided to senior citizens under Minn.Stat. § 325F.71 which provides for damages for conduct prohibited by §§ 325F.68-.69 relating to sources of retirement assets; Plaintiffs proffer that "[r]etirement accounts are typically invested in securities."(*Id.*) In response to Defendants' argument that the existence of the Minnesota Securities Act is proof that the MCFA does not cover securities, Plaintiffs point to the remedies sections of both Acts which provide that the remedies provided thereunder are in addition to other remedies provided by law. (*Id.* at 15-16 (citing §§ 8.31, subd. 3a; 80A.23, subd. 11.))

Heller replies that the *Jenson* language cited by Plaintiffs is dictum because the issue before the *Jenson* court was whether the MCFA should be read to impose strict liability on an accounting firm to ensure that its audits did not contain misleading statements-not how to interpret the word "merchandise." (Doc. No. 62 at 2.) RFC replies that the *Jenson* decision turned on the nature of the silver coin contracts at issue in that case, and the *Jenson* court "merely held that investment contracts of that nature were within the ambit of the [M]CFA; it did not purport to hold that securities sold on a public offering governed by the Minnesota Securities Act were also subject to the [M]CFA."(Doc. No. 64 at 3.) Heller argues that the *Meyer* decision simply followed the dictum in *Jenson* without analyzing the definition of "merchandise" under the MCFA. (Doc. No. 62 at 2 n. 1.) RFC contends that *Meyer* found the mortgage notes at issue there to be intangibles but the case did not address debentures and, "in any event, was [decided] prior to the *Loop* decision."(Doc. No. 64 at 3.) RFC argues that the *Loop* decision "is the best indication of current Minnesota law on the subject," and, if there is any doubt, contends that the Court should certify the question to the Minnesota Supreme Court. (*Id.* at 3.) As further proof that the MCFA does not apply to securities, Heller notes that the legislature did include "securities" within the ambit of § 325F.67 which concerns false statements in advertising, but did not include the term "securities" within § 325F.68 and 69 which concerns the prevention of consumer fraud, demonstrating that the Minnesota Legislature expressly includes "securities" where it intends securities to be covered by a statute. (Doc. No. 62 at 2.) As to Plaintiffs' claim that securities are intangibles, Heller contends that the applicable definition of "general intangibles" is "any property ... other than ... instruments" (Doc. No. 62 at 2 (citing Minn.Stat. § 336.9-102(a)(42)) and argues that "instruments" are securities as defined under the Minnesota statutes (*Id.* (citing § 80A.14, subd. 18(a)). Plaintiff responded at the motion hearing that the definition of "general intangibles" used by Heller derives from Article 9 of the Uniform Commercial Code (UCC) which does not apply to securities so it is not surprising that the definition would exclude securities which are instead covered under Article 8 of the UCC.

2. *Whether Plaintiffs' Claims Are a Public Benefit*

In the second prong of its attack on Plaintiffs' MCFA claims, Heller argues that Plaintiffs must show that their claims are a benefit to the public because their claims can only be brought through the private attorney general statute, Minn.Stat. § 8.31, subd. 3a, which incorporates the MCFA. (Doc. No. 39 at 7-8.) Heller argues that Plaintiffs seek only compensatory damages for their investment losses as individual investors and, thus, their claims have no public benefit. (*Id.* at 8.) Heller cites three decisions from this District in support of its proposition-*Evangelical Lutheran Church in America Board of Pensions v. Spherion Pacific Workforce LLC*, Civ. No. 04-4791, 2005 WL 1041487, at *4 (D.Minn. May 4, 2005) (dismissing MCFA claims because there was no public benefit where "recovery is sought for the exclusive benefit of the plaintiff"); *Zutz v. Case Corp.*, Civ. No. 02-1776, 2003 WL 22848943, at *4 (D.Minn. Nov. 21, 2003) (dismissing MCFA claims seeking compensatory damages for the benefit of plaintiffs because there was no public benefit); *Pecarina v. Tokai Corp.*, Civ. No. 01-1655, 2002 WL 1023153, at *5 (D.Minn. May 20, 2002) (dismissing an MCFA claim because it did not benefit the public).

Plaintiffs respond that the UHI debentures were sold to the general public and the "essence of Plaintiffs' case is that [D]efendants 'rip[ped] off a large number of citizens,' " a type of fraud that Plaintiffs claim the private attorney general statute is intended to cover. (Doc. No. 59 at 19 (quoting *Ly v. Nystrom*, 615 N.W.2d 302, 314 n. 21 (Minn.2000)). Plaintiffs also argue that the cases cited by Heller are distinguishable because, in all three cases, the recovery sought was for the exclusive benefit of the plaintiff. (*Id.*) Plaintiffs contend that their claims seek recovery on behalf of a class and seek a remedy for all of the debenture purchasers.(*Id.*) Plaintiffs also contend that MSF publicly advertised the debenture offering. (*Id.* at 18 n. 8.) Plaintiffs contend that misrepresentations to the public invoke the private attorney general statute and cite *Collins v. Minnesota School of Business, Inc.*, 655 N.W.2d 320 (Minn.2003) in support of this argument.

Heller replies that, "like the plaintiffs in the *Evangelical* case," Plaintiffs here "confuse[ ] large numbers with the public benefit."(Doc. No. 62 at 3 (citing *Evangelical*, 2005 WL 1041487, at *4.)) Heller contends further that, unlike the plaintiffs in the *Collins* case, Plaintiffs do not allege that the *MSF advertisements* cited by Plaintiffs contain misrepresentations, and Plaintiffs do allege that they "had only [the] oral representations [of MSF] to go on when they agreed to purchase" the debentures. (*Id.* at 4.) At best, Heller argues, Plaintiffs' MCFA claim is based on misrepresentations found in the prospectus and lender certificates which Plaintiffs received after they had become individual investors. (Doc. No. 62 at 4.) Heller cites to Davis v. U.S. Bancorp, 383 F.3d 761, 768 (8th Cir.2004) and Flora v. Firepond, Inc., 260 F.Supp.2d 780, 788 (D.Minn.2003), aff'd, 383 F.3d 745 (8th Cir.2004), for the proposition that fraudulent representations in these direct communications to investors do not constitute communications to the public. (*Id.*) Heller argues that *Davis* and *Flora* require that the misrepresentations in question be to the public at large to be actionable under the MCFA. (*Id.*) At the motion hearing, Plaintiffs argued that the advertisements, while not misleading themselves, drew the public into the fraud. Plaintiffs also argue that in promulgating Minnesota Rule 2875.3500, subp. 2, which requires the issuer of debentures to have sufficient funds to cover the interest on the offering, the Commissioner of the Minnesota Department of Commerce determined it is in the public interest to offer creditworthy, fixed income investments because the statute authorizing the rule's promulgation, Minn.Stat. § 80A.25, subd. 2 requires rules promulgated thereunder to be necessary or appropriate to protecting the public interest. (Doc. No. 1 ¶¶ 452-462, Doc. No. 59 at 18.)

3. *Whether Plaintiffs Have Alleged Loss Causation*

Defendants' third attack on Plaintiffs' MCFA claims focuses on loss causation-that an adequate causal nexus does not exist between the fraud alleged and Plaintiffs' economic loss. (Doc. No. 39 at 11-17; Doc. No. 42 at 10-13.) Heller argues that the United States Supreme Court, in Dura Pharmaceuticals, Inc. v.

Broudo, 544 U.S. 336 (2005), "confirmed that a plaintiff must plead (and prove) that the defendant's alleged misrepresentation proximately caused the plaintiff's economic loss."(Doc. No. 39 at 12.) Heller contends:

While *Dura* involved claims under the federal securities fraud statutes, the Court observed that the common law also requires that a plaintiff prove proximate cause to establish a fraud claim. In *Dura*, the plaintiffs alleged that false representations about the likelihood of FDA approval for a new asthma spray device caused them to purchase stock at an artificially high price. The district court [in considering a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6)] dismissed the complaint for failure to allege loss causation. The Ninth Circuit reversed the district court's dismissal, observing that "the injury occurs at the time of the transaction."The U.S. Supreme Court unanimously reversed the Ninth Circuit' s decision, finding that the economic loss occurs later, because "at the moment the transaction takes place, the plaintiff has suffered no loss."

(*Id.* at 12-13 (citing Dura, 544 U.S. at 339-45.)) Heller quotes a passage of the opinion in which the *Dura* Court describes a "tangle of factors" that might cause an economic loss:

> If the purchaser sells later after the truth makes its way into the market place, an initially inflated purchase price might mean a later loss. But that is far from inevitably so. When the purchaser subsequently resells such

> shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price. (The same is true in respect to a claim that a share's higher price is lower than it would otherwise have been-a claim we do not consider here.) Other things being equal, the longer the time between purchase and sale, the more likely that this is so, i.e., the more likely that other factors caused the loss.

(*Id.* (citing Dura, 544 U.S. at 342-43.)) Heller argues that the *Dura* opinion means "an inflated purchase price alone cannot be the proximate cause of the economic harm required for loss causation."(*Id.*) Quoting *Dura,* Heller contends that Plaintiffs' Complaint "must 'provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind.' " (*Id.*) Heller contends that Plaintiffs have not alleged facts which, if true, would show that Plaintiffs' financial loss was connected to Defendants' alleged misrepresentations because Plaintiffs' loss "did not occur until years later, when [UHI] failed to make payments on the Debentures and then filed for bankruptcy in March 2000." (*Id.* at 14.) Defendants also argue that, "the Complaint alleges that after 1997, '[UHI]'s Arizona activities' performed 'poorly' as a result of various factors, including 'zoning issues' and 'personnel issues.' " (*Id.;* Doc. No. 42 at 11-12 (citing Complaint ¶ 500.)) RFC argues that Plaintiffs' allegations concede that "[t]hese business failures (among others) caused [UHI] to lose revenue, and it stopped paying interest on the RFC loan in December 1998-over a year after RFC's initial letter." (Doc. No. 42 at 12 (citing Complaint ¶ 498.))

Heller further argues that: "Plaintiffs' alleged 'reliance' on 'MSF's implicit representation' that 'the Debentures were a meritorious investment,' (Compl.¶ 435), [is] similar to [that of] the plaintiffs in *Dura*, who alleged 'reliance on the integrity of the market.'*Dura*, [544 U.S. at 340]." (Doc. No. 39 at 15.) Heller continues:

> And, just as in *Dura*, such allegations are insufficient to plead proximate causation and economic loss. Plaintiffs do not-and cannot-allege that Heller or RFC ever used facts available in November 1997 to declare [UHI] in default on the loans. Heller's and RFC's letters, of course, did not guarantee that [UHI's] business would succeed. In short, the letters were not the proximate cause of [UHI's] bankruptcy and Plaintiffs' economic loss.

(*Id.* at 15 (citing *Dura*, 544 U.S. at 342-43.))

Similarly, RFC cites *Mikwalk v. Scura*, 691 F.Supp. 1218, 1222-23 (D.Minn.1998); *LeSage v. Norwest Bank Calhoun-Isles, N.A .*, 409 N.W.2d 536 (Minn.Ct.App.1987); and *Flynn v. American Home Products Corp.*, 627 N.W.2d 342, 350-52 (Minn.Ct.App.2001) as examples of cases where loss causation has been determined to be a necessary element of an MCFA claim. (Doc. No. 42 at 10.) Heller cites to Wiegand v. Walser Automotive Groups, Inc., 683 N.W.2d 807, 811 (Minn.2004) for the same proposition. (Doc. No. 62 at 6.) RFC contends that if the UHI debenture "investment failed for reasons other than the misrepresented facts, Plaintiffs do not raise a claim on which relief may be granted."(Doc. No. 42 at 10.) RFC argues that the Complaint alleges that RFC and Heller made misrepresentations to MSF by issuing lender certificates that stated UHI was not or could not be in default. (*Id.* at 11.)RFC argues that Plaintiffs allege that RFC and Heller's fraud on MSF in turn acted as a fraud on members of the putative class because MSF would not have underwritten the UHI debentures but for the false lender certificates. (*Id.*) RFC asserts that Plaintiffs do not allege that RFC declared a default based upon the facts known in November 1997 but, instead, the Complaint states that UHI defaulted approximately two years after the debentures issued. (*Id.*) RFC argues, "In the time between the November 1997 [lender certificate issuance] and [UHI]'s bankruptcy, the Complaint alleges that [UHI] was in compliance with RFC's loan covenants much of the time. Thus, the alleged ultimate fact RFC misrepresented-that it could have declared a default-never caused Plaintiffs any harm." (*Id.* (citation omitted.))

Plaintiffs concede that they must allege loss causation but contend that "Defendants' view of loss causation is overly restrictive."(Doc. No. 59 at 35.) At oral argument, Plaintiffs distinguished the *Dura* decision on the grounds that *Dura* was based on federal securities law which Plaintiffs argue is more stringent in its causation requirements than Minnesota law. Plaintiffs also argue that, under the

MCFA, a "loss is established if the loss is one that 'might be expected to follow from the fraud and from events that are reasonably foreseeable.' " *Id.* (quoting Specialized Tours, Inc. v. Hagen, 392 N.W.2d 520, 537 (Minn.1986)). Plaintiffs assert:

> Given that United's noncompliance under the Heller and RFC loan agreements went back to September 1996 and existed at the time the debentures were sold, the *Specialized Tours* test is satisfied: the worthlessness of the debentures certainly "might be expected to follow" if United could not comply with its senior lenders' loan agreements and if United was dependent upon that funding, which it was, to service the debentures. RFC's determination to stop lending to United was an event that was "reasonably foreseeable" at the time of the sales of debentures because of the then-existing defaults, which is why Miller would not have underwritten the debentures if Heller and RFC had been truthful about United's compliance with their loan agreements.

(*Id.* at 36-37.)

Plaintiffs contend that UHI was "in default of [Defendants'] loan agreements before, during and after the offering." (*Id.* at 27.) According to Plaintiffs, "To avoid having to disclose [UHI]'s default ... in its 1998 annual report, [UHI] and RFC connived to retroactively reset the debt/worth ratio so that [UHI] was no longer in default." (*Id.* (citing Compl. ¶ 278.)) Plaintiffs argue that even if the initial lender certificates were not fraudulent, RFC and Heller later knew that UHI had incorrectly calculated its debt/worth ratio prior to the issuance of the debentures and are liable to Plaintiffs for failure to correct their lender certificates. (*Id.* at 31-35.) Further, Plaintiffs submit that "Defendants' false certificates need not be the sole cause of Plaintiffs' injury" where their "fraudulent conduct concealed circumstances that bore on the ultimate loss."(Doc. No. 59 at 24 (citing *In re Parmalat Sec. Litig.*, 376 F.Supp.2d 472, 510 (S.D.N.Y.2005); *Le Sage*, 409 N.W.2d at 540.))

4. *Whether Plaintiffs' Aiding and Abetting Allegations Are Legally Sufficient*

Defendants also contend that the aiding and abetting claim fails because the Complaint does not allege facts sufficient to show that RFC and Heller provided "substantial assistance" to UHI or MSF or acted in concert with UHI or MSF pursuant to a common scheme. (Doc. No. 39 at 17-20; Doc. No. 42 at 14-15.) Defendants contend that Plaintiffs' theory of their case is that Defendants "deliberately, knowingly, intentionally and willfully withheld" from MSF information about the status of UHI's credit line. (Doc. No. 39 at 18 (citing Compl. ¶¶ 177, 201, 371, 414, 416.)) Defendants argue that this theory "is completely at odds" with Plaintiffs' allegation that Defendants "substantially assisted" MSF in defrauding Plaintiffs. (*Id.*) Defendants also argue that Plaintiffs' allegations show that Plaintiffs made their initial investment decisions based solely on oral representations made by MSF, not Defendants.(*Id.* at 19.)Finally, Defendants argue that they could not have "substantially assisted" MSF because the prospectus had already been approved by the SEC when Defendants provided their lender certificates. (*Id.*)

Plaintiffs respond that Defendants' omissions can provide a proper basis for aider and abettor liability where the plaintiff demonstrates that the defendant consciously intended to assist in the perpetration of the fraud. (Doc. No. 59 at 41 (citing *Metge v.. Baehler*, 762 F.2d 621, 626-28 (8th Cir.1985), *cert. denied*, 474 U.S. 1057 (1986)). Plaintiffs contend that Defendants intended their certificates to influence MSF in determining whether to underwrite the debentures, and investors purchased the debentures in transactions that Defendants intended to influence. (*Id.* at 45.) Plaintiffs argue that, "[w]here the defendant's knowledge is substantial, the assistance need not be substantial to establish aiding and abetting liability." (*Id.* (citing cases.))

Heller replies in part that its letter could not have substantially assisted in MSF's fraud because Heller's lender certificate was consistent with the prospectus and that, while its letter may have been necessary for [MSF]'s fraud ... it was not sufficient. The Prospectus already disclosed all of [UHI]'s financial information. Heller only provided one piece of information in its letter-confirmation from Heller that [UHI] was not in default. Such minor conduct cannot constitute substantial assistance to [MSF]'s conduct. (Doc. No. 62 at 9.) At the motion hearing, Plaintiffs argued that Heller aided and abetted MSF and UHI's fraud by remaining silent despite knowing their lender certificate representations were false.

B. *Common Law Fraud Claims Against RFC and Heller (Count 2)*

Defendants argue that Plaintiffs' common law fraud claims must be dismissed because: (1) an inadequate causal nexus exists between the fraud alleged and Plaintiffs' loss; (2) the aiding and abetting claims fail because the Complaint fails to allege facts sufficient to show that RFC and Heller provided "substantial assistance" to UHI or MSF or acted in concert with UHI or MSF pursuant to a common scheme; and (3) Plaintiffs fail to allege facts sufficient to show actual reliance on Defendants' lender certificates. (Doc. Nos.39, 42.) The first two of Defendants' arguments and Plaintiffs' responses to those arguments, are not substantially different from these same arguments raised in support of dismissing Plaintiffs' MCFA claims. Therefore, the Court will here only address Defendants' third argument that Plaintiffs fail to allege facts sufficient to show actual reliance on Defendants' lender certificate representations.

Defendants contend that detrimental reliance is a necessary element of a common law fraud claim not met by Plaintiffs' allegations. (Doc. No. 39 at 8-11; Doc. No. 42 at 13-14.) According to Defendants, Minnesota law requires "actual reliance," not just reliance based upon a defendant's creation of a market for goods. (Doc. No. 42 at 14 (citing *Flynn v. Am. Home Prods. Corp.*, 627 N.W.2d 342, 350-52 (Minn.Ct.App.2001)) and Doc. No. 39 at 9 (citing *In re Digi Int'l, Inc. Sec. Litig.*, 6 F.Supp.2d 1089, 1104 (D.Minn.1998), *aff'd*, Nos. 00-3162, 00-3227, 14 Fed. Appx. 714 (8th Cir. Jul 05, 2001) and other cases.))

Defendants concede that the Complaint contains the conclusory allegation that Plaintiffs "justifiably relied upon each of RFC's and Heller's Certificates by purchasing UHI's debentures from MSF without being told about UHI's past and existing violations of the Heller Credit Agreement and the RFC Loan Agreements ... or of the other adverse material facts known to Heller and RFC but not known to MSF and [P]laintiffs."(Doc. No. 39 at 9 (quoting Compl. ¶ 532.)) RFC, however, contends that Plaintiffs admit that they never, in fact, relied on RFC's certificate. (*Id.* at 14.) RFC cites to Plaintiffs' allegation that, "In relying on MSF's due diligence and determination to underwrite the Debentures in connection with their purchases of the Debentures, [P]laintiffs ... indirectly relied on the representations made by Heller and RFC to MSF that UHI was in compliance with the Heller and RFC loan agreements."(*Id.* (citing Compl. ¶ 436.)) Heller argues further that "the sequence of facts alleged in the Complaint make it impossible for Plaintiffs to prove actual reliance."(Doc. No. 39 at 9.) Heller cites to the forty-ninth numbered paragraph of the Complaint where Plaintiffs allege: "MSF sold the Debentures in a deceptive manner when it orally described the Debentures as worthy investments for investors seeking income investments and then, after the investors made their decision to invest, sending a prospectus that belied the oral representations."(*Id.* at 9.) Heller argues:

> [s]ince the Prospectus became effective before Heller and RFC provided their letters, by definition, those letters could not have been the basis for any statement in the Prospectus. Moreover, Plaintiffs did not receive the

> Prospectus until after they invested in the Debentures and thus they could not have relied on any statements in the Prospectus to make their investment decisions.

(*Id.* at 9-10.)While Heller concedes that "[s]ome court decisions uphold fraud claims on the basis of indirect representations made by a tortfeasor to a plaintiff through a third party," Heller argues that in those cases, "the representation actually passed from defendants to a third party and then to plaintiffs."(*Id.* at 11 n. 7 (citing as examples *Vikse v. Flaby*, 316 N.W.2d 276, 284 (Minn.1982) and *Kronebusch v. MVBA Harvestore Sys.*, 488 N.W.2d 490, 496 (Minn.Ct.App.1992))). Defendants contend the Complaint contains no allegations that the lender certification representations ever passed through MSF to Plaintiffs.

Plaintiffs do not contest Defendants' argument that Defendants did not make direct misrepresentations to Plaintiffs and concede that they received the prospectus after they decided to invest (*see* Doc. No. 59 at 22). Plaintiffs argue instead that indirect misrepresentations can be sufficient to meet the detrimental reliance element of common law fraud, as Heller concedes. (Doc. No. 59 at 20-24.) Moreover, Plaintiffs allege that UHI requested the lender certificates from RFC and Heller on November 5 and 10, 1997 and those certificates were delivered to MSF *before* MSF executed the underwriting agreement for the UHI debentures. (Compl.¶¶ 412-13.) Additionally, the Complaint alleges that the prospectuses that were delivered to debenture purchasers were delivered *after* MSF had received RFC's and Heller's lender certificates and that MSF would not have proceeded with the sales had Defendants informed MSF of UHI's true creditworthiness. (*Id.* ¶¶ 171-72, 294-96, 414-25.) Plaintiffs also assert that they allege in the Complaint that MSF and UHI had a continuing obligation under the Securities Act of 1993 to amend the debenture registration statement to include any information regarding UHI's default or potential default and would have filed a corrective registration statement if RFC and Heller had been truthful in their November 18, 1997 lender certificates. (*Id.* at 20-27.) In other words, UHI and MSF were simply seeking Defendants' assurance that their representation to the SEC about UHI's indebtedness made prior to receiving the lender certificates was truthful or they would have had to inform the SEC otherwise. (*Id.*) Plaintiffs contend that they reasonably relied on MSF's due diligence as the underwriter of the UHI debentures who in turn relied on Defendants' lender certificate representations. (*Id.*) Plaintiffs argue that Defendants should not be able to exploit MSF's failure to comply with SEC regulations which require a prospectus to be delivered to interested purchasers at least forty-eight hours before a sale of the securities described in the prospectus. (*Id.*) Finally, Plaintiffs argue that their reliance may be presumed because, had the respondents received information about the true financial state of the company, they might have reconsidered their decisions to purchase the corporate notes. (*Id.* at 25-27.)

Heller replies that the Complaint contains "no factual allegations that [MSF] told Plaintiffs about Heller's [lender certificate]." (Doc. No. 62 at 7.) Therefore, Defendants' actual representations are not alleged to have passed from Defendants to third parties and then to Plaintiffs. (*Id.*) Heller further contends that Plaintiffs' reliance on MSF as the underwriter does not automatically extend to Defendants because MSF was independently aware of UHI's financial condition. (*Id.*) Finally, Heller represents that the *Viske* case cited by Plaintiffs does not contain the words "presumption" or "presume." (*Id.* at 7 n. 6.) Heller argues that while there may be a presumption of reliance where violations of the Securities and Exchange Act are alleged based on some fraud-on-the market theory, Plaintiffs have brought no claims based on securities statutes and, in any case, there was no well-developed market for the UHI debentures as expressly stated in the prospectus. (*Id.* at 8.)

C. *Unjust Enrichment, Disgorgement, Restitution Against Heller (Count 3)*

Plaintiff claims Heller was unjustly enriched by its participation in the above alleged fraud and that Heller's profits should be disgorged as restitution for its actions. (Compl.¶¶ 543-49.) Heller moves to dismiss these claims because it argues the claims rest on Plaintiffs' statutory and common law fraud claims which fail as a matter of law for the reasons argued in support of dismissal of each of those individual claims. (Doc. No. 39 at 22-24.) Heller contends that unjust enrichment "requires proof that the enrichment was unjust in the sense that the term would mean " 'illegally or unlawfully.' " (*Id.* at 23 (quoting Mon-Ray, Inc. v. Granite Re, Inc., 677 N.W.2d 434, 440 (Minn.Ct.App.2004)). According to

Heller, because Plaintiffs' statutory and common law fraud claims fail, Plaintiffs cannot show unlawful or illegal conduct by Heller. (*Id.*) Likewise, Heller argues that "[d]isgorgement is not an appropriate remedy" because Plaintiffs "do not have a valid claim[ ] for damages." (*Id.* (citing *Montana v. Crow Tribe of Indians*, 523 U.S. 696, 718 (1998)). Finally, Heller argues restitution is unavailable "as a remedy because Plaintiffs cannot establish Heller's liability on the substantive claims for violation of" the statutory or common law fraud claims. (*Id.* (citing *Gatz v. Frank M. Langenfeld and Sons Const., Inc.*, 356 N.W.2d 716, 718 (Minn.Ct.App.1984)).

Plaintiffs counter that: (1) the fraud claims should prevail for the reasons it has set forth in defense of those claims; and (2) unjust enrichment, disgorgement, and restitution are claims which stand or fall independent of their fraud claims because unjust enrichment, disgorgement, and restitution are designed to rectify any unfair advantage or unconscionable conduct such as that alleged in their Complaint. (Doc. No. 59 at 48-50.) Thus, Plaintiffs contend that they are entitled to damages under a theory of unjust enrichment even if their other claims fail to state grounds upon which relief may be granted. At the motion hearing, Heller conceded that it received the money Plaintiffs seek to disgorge but argued that the business failed one and half years later so no causal connection exists between their receiving the money and the failure of the business.

D. *Alternative Relief Requested*

As alternative relief to outright dismissal of

Plaintiffs' claims, Defendants seek a court order striking the class action allegations because they argue that: (1) in a prior state court action, the trial court refused to certify the same claims and that refusal is preclusive of the issue; and (2) Plaintiffs' claims present various individual questions of liability that preclude class certification under Federal Rule Civil Procedure 23(b)(3). (Doc. No. 39 at 24; Doc. No. 42 at 15-21.)

Plaintiffs respond that they are not collaterally estopped from seeking class certification because (1) the issues are not identical because the state court litigation did not address (a) a claim for disgorgement, (b) how the §8.31 public benefit requirement affects class certification, (c) the similarity of oral representations that were not inconsistent with the prospectus, (d) the inconsequential effect of reliance on a class under the MCFA, (e) omissions and the presumption of reliance or fraud on the regulatory process on which Plaintiffs relied, and (f) MSF's deceptive practice of delivering the prospectus after the debenture sales were made; (2) no full and fair opportunity to be heard occurred at the state level because the matter settled after an interlocutory appeal of the class certification denial occurred; and (3) the settlement of the litigation is not binding on anyone other than the named plaintiffs in the state action because: no determination was made as to the fairness of the settlement on the class and no notice was given to the class of the settlement. (Doc. No. 59 at 51-55.) Plaintiffs also argue that individual issues do not predominate because: (1) the core fraud in the action involves broadly distributed disclosure documents disseminated to the public; (2) Defendants have not shown that any conflicts of law exist; (3) the remedies of unjust enrichment, disgorgement, and restitution implicate a limited fund which mandates a class under Federal Rule of Civil Procedure 23(b)(1)(B); (4) common law fraud is a common question or does not predominate because MSF's oral representations were uniform and MSF's brokers read UHI's prospectus before making the representations; and (5) causation is common and straightforward as to the proposed class of plaintiffs. (*Id.* at 55-78.)

III. DISCUSSION

In considering a Rule 12(b)(6) motion, the Court assumes all facts alleged in the complaint are true. *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984). All reasonable inferences from the complaint must be drawn in favor of the nonmoving party. *Hafley v. Lohman*, 90 F.3d 264, 266 (8th Cir.1996), *cert. denied*, 519 U.S. 1149 (1997). Dismissal is appropriate only if "it appears beyond a doubt that the plaintiff can prove no set of facts which would entitle the plaintiff to relief."*Coleman v. Watt*, 40 F.3d 255, 258 (8th. Cir.1994). Although "the complaint must contain sufficient facts, as opposed to mere conclusions, to satisfy the legal requirements of the claim to avoid dismissal,"*DuBois v. Ford Motor Credit Co.*, 276 F.3d 1019, 1022 (8th Cir.2002), a court may dismiss "only if it is clear that no relief can be granted under any set of facts that could be proved consistent with the allegations."*Hishon*, 467 U.S. at 73. With the above standard in mind, the Court now turns to an analysis of each of Plaintiffs' counts as alleged in their Complaint.

A. *Plaintiffs' Claims Fail Because They Fail to Adequately Plead Loss Causation*

To show a violation of the MCFA: "(1) there must be an intentional misrepresentation relating to the sale of merchandise, and (2) the misrepresentation must have caused damage to the plaintiff."*Wiegand v. Walser Auto. Groups, Inc.*, 670 N.W.2d 449, 452 (Minn.Ct.App.2003) (citing *Group Health Plan, Inc. v. Philip Morris, Inc.*, 621 N.W.2d 2, 12 (Minn.2001)), *rev'd on other grounds*,683 N.W.2d 807 (Minn.2004).

A claim for fraud (also known as intentional misrepresentation) has five elements:

(1) there was a false representation by a party of a past or existing material fact susceptible of knowledge;

(2) made with knowledge of the falsity of the representation or made of the party's own knowledge without knowing whether it was true or false;

(3) with the intention to induce another to act in reliance thereon;

(4) that the representation caused the other party to act in reliance thereon; and

(5) that the party suffer pecuniary damage as a result of the reliance.

Specialized Tours, 392 N.W.2d at 532. The fourth element is also called transaction 24 causation.

"Transaction causation is established when the plaintiff shows that the defendant's fraudulent conduct caused the plaintiff to engage in the transaction in question. This is nothing more than 'but for' causation, which is merely another way of describing reliance." *Harris v. Union Elec. Co.*, 787 F.2d 355, 366 (8th Cir.1986), *cert. denied,*479 U.S. 823 (1986); *see also* *Specialized Tours*, 392 N.W.2d at 538 ("[T]ransaction causation [exists where] the violation caused the plaintiff to engage in the transaction in question[.]")."Courts often label the fifth element 'loss causation' in the context of investments."*Spiegel v. Besikof*, No. C4-95-958, 1995 WL 697559, at *3 (Minn.Ct.App. Nov. 28, 1995), *rev. denied* (Jan. 25, 1996). "[L]oss causation [exists where] the misrepresentation or omission caused the economic harm."*Specialized Tours*, 392 N .W.2d at 538.

In an action sounding in fraud, "the aggrieved party must show not only detrimental reliance on the false representation or omission, but also that the false representation or omission caused the economic harm"-loss causation.*Zacharias v. Polinsky*, No. C3-03-304, 2003 WL 21694591, at *1 (Minn.Ct.App.2003) (citing *Specialized Tours*, 392 N.W.2d at 538). An allegation that a plaintiff would not have invested in a security had he been aware of certain misrepresentations or omitted facts is transaction causation, not loss causation. *Zacharias*, 2003 WL 21694591, at *2.

The Court finds that Plaintiffs' complaint fails to state a claim upon which relief may be granted because plaintiff fails to demonstrate an adequate causal nexus between the underlying fraud alleged and Plaintiffs' economic loss. Plaintiffs concede that they must show some loss causation to succeed on their claims. (Doc. No. 59 at 35.) As in *Dura,* where the underlying trial court also ruled on a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), to survive Defendants' motion to dismiss based on failure to adequately allege loss causation, Plaintiffs must have set forth sufficient factual allegations in their Complaint that Defendants' 1997 letters caused their investment losses. The *Dura* Court recognized that, "[o]ther things being equal, the longer the time between the purchase and sale, the more likely that...other factors" such as "changed economic circumstances...new industry-specific or firm-specific facts, conditions, or other events...taken separately or together account for some or all" of the loss alleged. 544 U.S. at 343. The Court does not find persuasive Plaintiffs' argument that *Dura's* analysis of loss causation should be less stringently applied when considering Plaintiffs' state law claims because the *Dura* Court was addressing a question of federal securities law. "This is a distinction without a difference. *Dura* stands for the proposition that the allegations, 'I paid an inflated price' or 'I would not have acted in the same way if I had known the truth' are insufficient without [causally related] actual economic loss." *Carey v. Select Comfort Corp.,* No. 27CV 04-015451, 2006 WL 871619, at *3 (Minn.Dist.Ct. Jan. 30, 2006). Quoting Prosser on Torts, the Minnesota Supreme Court in *Specialized Tours,* stated: "[I]f false statements are made in connection with the sale of corporate stock, losses due to a subsequent decline in the market...or other factors in no way relate[d] to the representations will not afford any basis for recovery."392 N.W.2d at 537.

In this case, Plaintiffs do not allege that they suffered an economic loss at the time they purchased the debentures in November and December of 1997 (Complaint ¶¶ 23-25, 49). In April 1998, Heller informed UHI it was in default and in November 1998, RFC informed Heller it was in default. (*Id.* ¶¶ 226, 382.)Plaintiffs do not allege that Defendants' actual default determinations were based on facts available to Defendants when their lender certificates issued. UHI did not enter bankruptcy until March 9, 2000 (*Id.* ¶ 518), more than two years after Defendants made their alleged misrepresentations. In light of the length of time between the alleged misrepresentations and given the lack of factual allegations linking Plaintiffs' loss and Defendants' lender certificate representations and the likelihood of intervening factors which contributed to the loss, the Court finds that Plaintiffs do not state claims upon which relief may be granted. *See* Dura, 544 U.S. at 343 ("[T]he longer the time between purchase and sale, the more likely that ... other factors caused the loss.") While it is possible that Defendants' lender certificates might have "touched upon" Plaintiffs' loss, "[t]o 'touch upon' a loss is not to cause a loss, and it is the latter that the law requires."*Id.*

Similarly, Plaintiffs' claims that Defendants aided and abetted MSF and UHI in committing violations of the MCFA and common law fraud (Compl.¶¶ 527-28, 541-42) fail because Plaintiffs fail to alleged facts sufficient to prove loss causation. Even assuming that there exists transactional causation between MSF and UHI's misrepresentations and Plaintiffs' decision to invest in the debentures (i.e., that Plaintiff relied on the misrepresentations in making their investment decisions), Plaintiffs cannot show, based on the allegations in their Complaint, that MSF's or UHI's fraud in inducing them to buy the debentures caused their economic loss for the same reasons given above.

Similarly, Plaintiffs' unjust enrichment claim fails because Plaintiffs have not shown a sufficient nexus between the loss resulting from the alleged wrongful conduct and Defendants' lender certificates. The Court also concurs with Defendants that Plaintiffs' statutory and common law fraud claims fail because Plaintiffs cannot show unlawful or illegal conduct by Defendants. The unjust conduct alleged must be conduct approximating or equivalent to illegal behavior, *see Mon-Ray, Inc.*, 677 N.W.2d at 440, and without valid fraud claims, Defendants' conduct does not cross that threshold. Plaintiffs' disgorgement and restitution claims fail for similar reasons. *See Montana v. Crow Tribe of Indians*, 523 U.S. 696, 718 (1998); *Gatz v. Frank M. Langenfeld and Sons Const., Inc.*, 356 N.W.2d 716, 718 (Minn.Ct.App.1984).

B. *Plaintiffs' MCFA Claim Also Fails Because Plaintiffs' Lawsuit Lacks a Public Benefit*

The MCFA, the relevant provision of which is codified at Minn.Stat. § 325F.69, provides:

> The act, use, or employment by any person of any fraud, false pretense, false promise, misrepresentation, misleading statement or deceptive practice, with the intent that others

> rely thereon in connection with the sale of any merchandise, whether or not any person has in fact been misled, deceived, or damaged thereby, is enjoinable as provided in section 325F.70.

Minnesota's private attorney general statute provides in part: "In addition to the remedies otherwise provided by law, any person injured by a violation of [the MCFA] may bring a civil action and recover damages, together with costs and disbursements, including costs of investigation and reasonable attorney's fees, and receive other equitable relief as determined by the court."Minn.Stat. § 8.31, subd. 3a. [T]he sweep of the [private attorney general] statute can be no broader than the source of its authority-that of the attorney general-whose duties are to protect public rights in the interest of the state. Conversely, it is not the responsibility of the attorney general to protect private or individual interests independent of a public purpose.

Ly v. Nystrom, 615 N.W.2d 302, 313 (Minn.2000). "The class of plaintiffs under the private attorney general statute would be limitless if [courts] assumed that one individual's negative experience with a company was necessarily duplicated for every other individual and on that basis treated personal claims as benefitting the public."*Davis*, 383 F.3d at 768.

Even assuming Plaintiffs are correct and the MCFA applies to securities like the debentures at issue, Plaintiffs fail to set forth a legally sufficient MCFA claim because they do not allege facts, that, if true, would show that their lawsuit is brought to secure a public benefit. "To determine whether a lawsuit is brought for the public benefit the Court must examine not only the form of the alleged misrepresentation, but also the relief sought by the plaintiff." Evangelical, 2005 WL 1041487, at *4. Plaintiffs' argument that a public benefit derives from their lawsuit because they seek to represent all purchasers of the UHI dentures (*see* Doc. No. 59 at 19) is not a sufficient factual allegation to survive a motion to dismiss. In *Evangelical,* the plaintiff pension board argued that the fraud afflicted on it affected not only Evangelical, but also the tens of thousands of people who benefitted from its pension plans and the millions of Evangelical members who could potentially have benefitted from Evangelical's plans. 2005 WL 1041487, at *4. The *Evangelical* court stated that Evangelical "confuses large numbers with the public benefit. Evangelical is undisputedly a private organization, and any remedies sought in this case will enure solely to Evangelical."*Id.* Here, unlike the plaintiff in *Evangelical,* Plaintiffs seek to pursue relief on behalf of a number of investors. But, ultimately, the benefit that will result, if they succeed, will accrue to the exclusive benefit of those individual investors because the "redress" sought "is to compensate Plaintiffs for their injuries." *Pecarina v. Tokai Corp.*, Civ. No. 01-1655 ADM/AJB, 2002 WL 1023153, at *5 (D.Minn. May 20, 2002) (dismissing, pursuant to Rule 12(b)(6), a MCFA claim brought by the parents of children burned when using a product without a child-safety mechanism because, despite the parents' claims that the injuries resulted from a transaction between a large manufacturer and retailer and members of the consuming public involving fraud and false advertising, "the essence of [the p]laintiffs' lawsuit [was] personal injury, involving allegations of negligence and products liability").

Finally, Plaintiffs' attempt to revive their MCFA claim by alleging the public was drawn into their debenture purchase through MSF's advertising of the debentures to the public also fails. Plaintiffs do not contend that Defendants developed or paid for the advertisements; they were MSF advertisements. More importantly, Plaintiffs do not contend that the advertisements contained misrepresentations. As noted by Defendants, in the *Collins* case cited by Plaintiffs, the misrepresentations at issue *were contained in* advertisements to the public. *See* Davis, 383 F.3d at 768 (noting that "because the misrepresentations [in Collins] ... were made to the public at large in a television advertisement, successful prosecution of the claims would ... benefit the public"); Flora, 260 F.Supp.2d at 788 ("In *Collins,* because the fraud occurred in advertising that reached out to the public generally, the Court found that a private action would benefit the public.") Finally, Plaintiffs do not allege that the oral misrepresentations made to them prior to the purchase made any mention of Defendants' lender certificates or any other misrepresentations made by Defendants. On these facts, Plaintiffs' suit is not one brought to "protect public rights in the interest of the state," *Ly*, 615 N.W.2d at 313, and they are not acting as private attorney generals.[3] Thus, they cannot succeed on their MCFA claims as a matter of law.

---

[3] Furthermore, while the Commissioner of the Minnesota Department of Commerce may have determined it is in the "public interest" to offer creditworthy, fixed income investments and, thus, promulgated Minnesota Rule 2875.3500, subp. 2, this

C. *Plaintiffs' Common Law Fraud Claim Also Fails Because Plaintiffs Fail to Allege Reliance*

"[C]ommon-law fraud .... require[s] *actual* reliance."*In re Digi*, 6 F.Supp.2d at 1104. It is not necessary for the person relying on the misrepresentation to have personal contact with the person against whom suit is brought. *See* *Vikse*, 316 N.W.2d at 284. For purposes of this motion the Court accepts as true Plaintiffs' allegations that the lender certificates contained misrepresentations. Plaintiff summarizes its reliance allegations as follows:

> Here, Defendants' representations to [UHI] and [MSF], which confirmed [UHI]'s and [MSF]'s representation to the SEC and in the prospectus, without which representations the SEC would not have cleared the prospectus and [MSF] would not have underwritten the debentures, establish the causal nexus required by the CFA. Also, Plaintiffs relied on [MSF] to do its job to ascertain the merits of the debentures, and [MSF] in turn relied on Defendants' certificates. Finally, Defendants' representations supplied the basis for the statement in the prospectus sent to Plaintiffs that [UHI] was in compliance.

---

rule, alone, is not sufficient to convert Plaintiffs' lawsuit-which is otherwise brought on behalf of private plaintiffs to redress their private losses and which is not brought under or to enforce Rule 2875.3500-into an action brought to protect public rights in the interest of the state.

(Doc. No. 59 at 20 n. 9.) While a fraud claim may be maintained where a third party passes along a misrepresentation made by a defendant, to survive a motion to dismiss, the plaintiff must set forth legally sufficient factual allegations that the defendant's misrepresentation actually reached the plaintiff and that he relied on the defendant's misrepresentation in going forward with the transaction. *See* Vikse, 316 N.W.2d at 284 (finding actionable fraud where an independent contractor passed along false information about the finances of a company given to the contractor by defendants where they "knew and intended that [the contractor] would be passing on [the false] information to potential investors"). For example, in *Kronebusch v. MVBA Harvestore Sys.* the Minnesota Court of Appeals upheld a challenge to a jury instruction on "indirect representations" after the defendant manufacturer had been found liable for fraud because the manufacturer's specific misrepresentations concerning the performance of silos was passed onto farmer purchasers by a silo dealer. 488 N.W.2d 490, 496 (Minn.Ct.App.1992), *rev. denied* (Oct. 20, 1992). The present case is distinguishable because Plaintiffs do not allege that Plaintiffs received the alleged misrepresentation by Defendants *prior to* making their investment decision. Plaintiffs' argument that they later received a written prospectus that was based upon the misrepresentations also fails because Plaintiffs concede they made their investment decisions based upon oral representations made by MSF before ever receiving the written prospectus. (*Id.* ¶¶ 23-25, 49.) Plaintiffs claim they relied on "MSF's *implicit* representation, by underwriting the Debentures, that no material negative or adverse information about

UHI existed and that the Debentures were a meritorious investment."(Compl. ¶ 435 (emphasis added.)) This claim and Plaintiffs' other theories of reliance are too tenuous to support the reliance element of common-law fraud. Having failed to allege legally sufficient factual allegations to show reliance, Plaintiffs' claim does not state a basis upon which relief may be granted.

THEREFORE, IT IS HEREBY RECOMMENDED that:

1. Defendants' Motion to Dismiss and/or Strike (Doc. No. 33) be **GRANTED;** and

2. All of Plaintiffs' claims be **DISMISSED.**